

NOTES TO THE FINANCIAL STATEMENTS

(I). OVERVIEW OF THE COMPANY

Guangzhou Shipyard International Company Limited (the “Company” and its subsidiaries) was reorganized in 1993 from Guangzhou Shipyard, and incorporated in the PRC as a joint stock limited company. Upon approval, the Company was registered as a sino-foreign joint stock limited company on October 21, 1994.

Currently, the Company is the largest modernized and comprehensive shipyard in southern China and enjoys the autonomy of operating import and export business.

At present, the Company owns three shipbuilding berths ,shipbuilding and ship-repairing quay, and a ship-repairing dock which can undertake repairing and modification work for ships up to 10,000dwt. It also owes processing lines for steel plate and large pipe; and production lines for steel structure engineering and elevator and other electro-mechanic products.

The Company presently has 4 major operations, including shipbuilding, ship-repairing, steel structure engineering, and other mechanical and electrical equipment. In addition to large vessels, the Company's principal products include steel structure's manufacturing, coating & erecting for bridges & high-rise construction & large-size pipe, manufacturing & installing of passenger/goods lift, foils and studs for hydrofoil, port machinery, hydraulic machines, production line for external painted steel plates of refrigeration and design & manufacturing of crane machinery.

(II). PRINCIPAL ACCOUNTING POLICIES ADOPTED BY THE COMPANY (GROUP)

1. Accounting System

The Company adopts the Enterprise Accounting Standard and the Enterprise Accounting System and relevant regulations issued by the PRC Financial Department.

2. Accounting Period

The accounting period covers the calendar year from January 1 to December 31.

3. Currency Adopted in Accounting Records

Accounting records are maintained in Renminbi.

4. Basis of Recording and Valuation

Basis of recording adopts accrual system and Basis of Valuation is cost of acquisition. Devalue provision is made in accordance with the Enterprise Accounting System if there is any devalue of any asset.

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5. Foreign Currency Translation

Foreign currency translations during the year are translated into Renminbi at the exchange rates quoted by the People's Bank of China on the first day of the month in which the transactions take place. At the end of the month, the monetary balances are adjusted in accordance with the regulations of Accounting System with the differences arising stated as exchange difference.

6. Cash Equivalents

Cash equivalents are defined as investments that are short-term (within three months), highly liquid, and readily convertible to cash and are subject to low risk of changes in value.

7. Short-term Investment and Profit

The short-term investment, including shares, bonds and funds, refers to the investment that can be realized at any moment, and the time of holding the investment does not exceed 1 year (including 1 year). The investment is calculated on basis of the cost of the investment while returning the investment. At the end of the term, short-term investment is valued in accordance with the lower between the cost and market price. When the market price is lower than the cost, provision for diminution is made.

8. Provisions for Doubtful Debts

- (1). Basis of recognition as of doubtful debts lost: If cases where debtors to bankrupt or is dead, doubtful debts unpaid represent balance after settlement out of liquidation or estate; The debtor do not pay back debt overdue, and certify it is impossible to get back after litigation process.
- (2). Accounting basis of doubtful debts lost: provision way.
- (3). Provision and applicable rate: For the account receivable which there is no bad information of in-receivable, 0.5% of its left will be draw out as provision; For the account receivable which there is special disadvantageous information for the bad debts, the provision will draw in accordance with the difference between the returnable amounts of debts and its book account.

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9. Inventories

Inventories of the Company are valued on the basis of cost, including:

- (1). Raw materials and low-value consumables are stated at standard costs. The amount is adjusted for price variance to arrive at actual cost at the end of month.
- (2). Low-value consumables are amortized upon issuance for use.
- (3). Finished products and work-in-progress are stated at actual cost.

Methods of making provision for diminution of value on inventories:

- (1). For materials (excluding those special materials for the products with the support of contract), provision is made on those damaged or rotten materials based on the difference between cost and net realizable value.
- (2). For construction contracts (including products under long-term contracts), provision is made against total impact of foreseeable loss.
- (3). For finished goods

For finished goods covered by contracts, provision is made based on the difference between cost and sales proceeds when the actual cost is more than the foreseeable operating income.

10. Long-term Investments

- (1). Long-term equity investments

Long-term equity investments by the Company are stated as the investment cost.

For enterprises in which the Company's investment representing more than 50% of the investee's issued capital, equity method of accounting is adopted and consolidated financial statements are prepared.

For enterprises in which the Company has made an investment representing more than 20% but equal to or less than 50% of the investee's issued capital, equity method of accounting is adopted and no consolidated financial statements are prepared generally except where the Company has control over the investing project.

The Company's investments representing 20% or less of the investee's issued capitals are stated at cost.

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- (2). The balance of the equity investment, the term of which is stipulated in the contract, is amortized and included as current income of investment according to the investment term; while those, the term of which is not stipulated in the contract, are amortized and included as current income of investment according to the term that does not exceed 10 years (including 10 years).
- (3). Long-term bond investments: Bonds invested by the Company are regarded as original investment cost according to the exact payment. The interest, included by the exact payment, will be stated dividually as item receivable when the interest is at the expiration but not drawn. The original investment cost of long-term bonds includes the bond interest that is included by the exact payment and does not expire.
- (4). The amortization of premium and discount of long-term bond investment is carried out at the same time with the confirmation of the relevant bond interest in order to adjust the investment income.
- (5). Provision for diminution in long-term investments
 - (i) Provision for diminution in long-term investments that have market price is made according to the following symptom.
 - A. Market price lower than the account price for the 2 years
 - B. The transaction of investment suspended for one year or more
 - C. The company invested have a serious loss in this year
 - D. The loss of the company invested lasted for 2 years
 - E. The company invested is in process of rectification and liquidation or the company invested has other symptoms that show it cannot do business continually.
 - (ii) Provisions for diminution in long-term investments that have not market price are made according to the following symptom.
 - A. The company invested has a mint loss.
 - B. The financial status of the company invested has deteriorated, such as the rectification and liquidation, etc, because of the change of market and the descent of the competitive ability.

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- C. In other case, for example, it shows evidence that the investment actually did not bring any economic interest to the Company.

11. Fixed Assets and Depreciation

Fixed assets refer to the house, building, machinery and the equipment of transportation that have been used for one year or more, including other equipment related to the production and business. Fixed assets are stated at cost.

Depreciation is provided to write off the cost over their useful lives on a straight-line method, after taking into account the estimated residual value of 3% to 10% of the cost. The annual rates of depreciation for various categories of fixed assets are as follows:

| Fixed assets category | Service years | Depreciation rate (%) |
|-------------------------|---------------|-----------------------|
| Machinery and equipment | 6-20 | 5-16.67 |
| Transmission systems | 8-35 | 2.86-12.5 |
| Instrument and meters | 5-10 | 10-20 |
| Vehicles | 10-15 | 6.67-10 |
| Building | 8-50 | 2-12.5 |
| Structures | 15-50 | 2-6.67 |

Provision for diminution is made when the fixed assets comply with one of the items in the following.

- (1). The fixed assets, left unused for a long time, will not be used in the foreseeable future and no any transference value.
- (2). The fixed assets left unused for the sake of the technical advance.
- (3). The fixed assets produced a great number of rejects, although the fixed assets can be used.
- (4). The fixed assets, no any use and transference value because of damage.
- (5). The fixed assets, actually no any economic interest to the Company.

At the end of term, the value of fixed asset is calculated in accordance with the lower between the accounting value and the receivable value. When the receivable sum is lower than the accounting sum, the balance will be regarded as the fixed assets provision for diminution that is stated in accordance with one asset.

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12. Construction-in-process

Construction-in-process is stated at cost. The relevant interests are included as project cost before the project is delivered for use. The project is considered to list into fixed assets as the project is delivered for use. For the project could be delivered for use but not process the final account for completed project, from the date of the project could be delivered, and in accordance with the budget and the construction value of the project, the project could be transferred into fixed assets, and drawn depreciation in accordance with relevant regulations of Enterprise Accounting System. The readjustment will make after the final account for completed project was processed. The Company will made devalue provision on the construction-in-process met following situations:

- (1). Constructions paused for long-term and was not anticipated to re-commence in 3 years.
- (2). Constructions that were enough proved the situation of devaluing.

13. Loan Expenses

When the following three requirements are met simultaneously, the expenses of loan in order to buy or construct a fixed asset is capitalized and covered by the cost of the asset.

- (1). The payout (only including cash paid, transferred non-currency assets or holding debt liability) has been occurred.
- (2). The expenses of loan have been occurred.
- (3). The action of buy and construction, which are indispensable in order to reach the scheduled workable condition, has begun.

The loan expenses for buying or constructing fixed assets, fulfilling the condition of capitalization and the fixed assets reaching the scheduled workable condition, can be stated as cost of fixed assets. The loan expenses occurred after the construction was reached the scheduled workable condition would be stated as the current financial expenses.

Method for calculating capitalized interest for each accounting period:

The weighted average of accumulated outlay for buying and constructing fixed assets as to the end of the period x capitalization rate

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14. Intangible Assets and Its Amortization

Intangible assets are state at cost. Amortization is provided to write off the cost evenly over the legal or contractual lives or, in the absence of legal or contractual lives, evenly over the useful lives. Where the useful lives of intangible assets cannot be ascertained, amortization is provided evenly over a period of not less than 10 years. The Company will made devalue provision to the balance between the book-value and the anticipated receivable amount of the intangible assets which met following situations:

- (1). An Intangible asset whose profitability was adversely affect significantly to the economic interest of the enterprise, or has no usable value and transferring value.
- (2). An Intangible asset which exceed the legal protection time limited, and wholly or partially lost its usable value and transferring value.
- (3). The market price of an intangible asset decreased in a large degree, and was not anticipated could recover in the rest amortization years.
- (4). Other intangible assets that were enough proved the situation that its use value and transferring value was lost wholly or partially.

15. Long-term Deferred Expenses and Amortization

Long-term deferred expenses are amortized evenly during favorable period of expense items.

16. Income Realizing Principle

Commodity sale: the Company has no any managing and controlling right after the important risk and reward has been transferred to the seller. The evidence of receiving money has been possessed in respect of the relevant income and the cost concerning the commodity sale can be calculated reliably in order to confirm the business income.

Labor services: the contract has been executed and the sum of money in contract or the evidence of receiving money has been received.

When the result of construction contract (long-term contract engineering) is foreseeable, it is to calculate the business income on basis of the percentage of the construction progress when settle accounts, and to calculated the business cost on basis of the same percentage of scheduled cost. The provision for loss, which consists of the whole cost of construction, will be made when foreseeable loss. Generally, in accordance with the situation of the Company could anticipate the result for the contracts of a long-term project such as a first-made shipbuilding contract (or new order) reasonably when the construction progress reached 50%. And for the ships of batch production, the Company could anticipate the result when the construction progress reached 30%.

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Unrealized operating income of foreign currency construction contract is to be calculated on basis of recording exchange rate of the period, contract price and the percentage of scheduled cost. Total foreseeable operating income is the sum of unrealizable and realized operating income. When the project is accomplished or at the end of accounting period, the balance of accumulated operating income and scheduled result is considered as exchange profit and loss, and recorded as financial expenses in Profit and Loss Statement.

Income from transferring assets using right was confirm when the relevant economic interest could inflow or the amount received could be accounted reliably.

17. Income Tax

The income tax of the Company is on basis of accrual basis.

18. Basis of Preparation of Consolidated Financial Statements

In accordance with the "Tentative Regulations for Consolidated Financial Statements" issued by Finance Ministry, enterprises that the Company holds over 50% of total equity, or even less than that, but gets the actual holding rights, is consolidated into the accounting statements.

(III). TAXATION

1. The type and rate of tax applicable to the major business activities are:

| Activity Category | Tax category | Tax rate |
|---|-----------------|----------|
| Shipbuilding, Ship-repairing, Steel structures & mechanical and electrical equipment manufacturing, and sales materials | Value-added tax | 17% |
| Transportation and installation | Sales tax | 3% |
| Other services | Sales tax | 5% |

2. The Company's income tax is calculated at 15% on the assessable profit.

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(IV). PRINCIPAL SUBSIDIARIES AND AFFILIATES

1. Principal Subsidiaries

| Name | Registered Capital (‘000) | Principal Business | Investment Capital (‘000) | Interest Attributable to the Company (%) | Indirect Interest (%) |
|--|------------------------------|---|------------------------------|---|--------------------------|
| Masterwood Company Limited | RMB3,315 | Manufacture and sales of all kind of material furniture series | RMB933 | 51 | 25 |
| Guangzhou Guanglian Container Transportation Company Limited | RMB20,000 | Container transportation | RMB15,000 | 75 | |
| Guangzhou Xinsun Shipping Service Company Limited | RMB2,000 | Installation, welding, fitting, coating, repairing of hull structure | RMB500 | 83 | |
| United Steel Structures Limited | USD 8,850 | Manufacturing, sales and post sales service of steel structure | RMB37,522 | 51 | |
| Guangdong GSI Elevator Limited | RMB21,000 | Design, manufacturing, sales, installation, modification and repairing of all kinds of elevator | RMB19,950 | 95 | 3.8 |
| Guangzhou Hongfan Information Technique Co., Ltd. | RMB5,000 | Developing of computer software, system integration and sales | RMB3,850 | 77 | |
| Glory Group Developing Co., Ltd. | HKD10 | Trading | RMB10.44 | 100 | |
| Indirect holding subsidiaries | | | | | |
| Guangzhou Hongfan Hotel | RMB10,000 | Traveling and catering services | RMB10,000 | 86.16 | Yes |
| Guangdong GSI Elevator Limited | RMB21,000 | Elevator manufacturing | RMB350 | 3.8 | Yes |
| Masterwood Company Limited | RMB3,315 | Manufacture and sales of all kind of material furniture series | RMB829 | 25 | Yes |
| Fonkwang Development Ltd. | HKD200 | General trade | HKD140 | 70 | Yes |

Except Fonkwang Development Ltd. and Glory Group Developing Co., Ltd. were registered in Hong Kong, other above subsidiaries are established and operated in Mainland China.

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- (2) Holding subsidiaries out of the scope of consolidation in this period: The 70% interest in Xinhui City Guangzhou Shipyard Nanyan Shipping Industrial Company of the Company has been transferred to an investor by RMB13.52 million on March 9th 2005 according to the Resolution of the 11th meeting of the 4th term of the Board of the Company. The transfer has been completed in this period.

(V). NOTES TO ITEMS IN THE FINANCIAL STATEMENTS (UNIT: RMB, UNLESS SPECIAL STATEMENT)

1. Cash and Bank Balances

| Item | As at December 31, 2005 | | As at December 31, 2004 | |
|---|-------------------------|----------------|-------------------------|----------------|
| | Foreign currency | Equivalent RMB | Foreign currency | Equivalent RMB |
| Cash | | | | |
| RMB | | 225,860.75 | | 214,827.77 |
| HKD | 31,336.93 | 32,590.63 | 114,507.62 | 122,498.17 |
| USD | 2,907.17 | 23,463.48 | 3,310.17 | 27,396.62 |
| JPY | 500.00 | 34.23 | 500.00 | 39.85 |
| EUR | 4,438.84 | 42,445.96 | 5,310.84 | 59,814.40 |
| POUND | 250.00 | 3,462.72 | | |
| Sub-total | | 327,857.77 | | 424,576.81 |
| Deposit | | | | |
| RMB | | 571,690,211.11 | | 336,447,268.52 |
| HKD | 4,676,707.50 | 4,865,433.16 | 1,356,502.10 | 1,446,997.80 |
| USD | 6,997,303.12 | 56,472,090.47 | 4,066,250.21 | 33,664,043.07 |
| EUR | 1,026,184.42 | 9,812,979.07 | 315,358.80 | 3,476,372.45 |
| | — | — | | |
| Sub-total | | 642,840,713.81 | | 375,034,681.84 |
| Deposit in CSSC Financial Co. (Note) | | 928,326.17 | | 1,852,930.75 |
| Others | | | | |
| RMB | — | 141,156.13 | | 191,846.73 |
| USD | 23,776.27 | 191,895.90 | 23,735.64 | 196,448.02 |
| Subtotal | | 333,052.03 | | 388,294.75 |
| Total | | 644,429,949.78 | | 377,700,484.15 |

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Note: CSSC Financial Co., parented by China State Shipbuilding Corporation, is a non-banking financial corporation approved and supervised by the People's Bank of China.

Cash and Bank Balance increased by 70.62% compared with the beginning of the period, mainly due to the increase of cash received relating to operating activities.

2. Accounts Receivable

(1). Accounts Receivable

| Bond age | Amount | Percentage % | December 31, 2005 | | Net receivable |
|---------------|-----------------------|--------------|------------------------------|------------------------------|-----------------------|
| | | | Provision for doubtful debts | Percentage of doubtful debts | |
| Within 1 year | 197,836,905.97 | 87.11% | 989,181.54 | 0.50% | 196,847,724.43 |
| 1-2 years | 17,474,709.70 | 7.69% | 87,373.55 | 0.50% | 17,387,336.15 |
| 2-3 years | 3,561,887.94 | 1.57% | 17,809.44 | 0.50% | 3,544,078.50 |
| 3-4 years | 1,771,699.90 | 0.78% | 8,858.50 | 0.50% | 1,762,841.40 |
| 4-5 years | 923,746.50 | 0.41% | 4,618.73 | 0.50% | 919,127.77 |
| Special | 5,554,612.99 | 2.44% | 5,554,612.99 | 100.00% | — |
| Total | <u>227,123,563.00</u> | <u>100%</u> | <u>6,662,454.76</u> | <u>—</u> | <u>220,461,108.24</u> |

| Bond age | Amount | Percentage % | December 31, 2004 | | Net receivable |
|---------------|-----------------------|--------------|------------------------------|------------------------------|-----------------------|
| | | | Provision for doubtful debts | Percentage of doubtful debts | |
| Within 1 year | 168,848,858.09 | 87.59% | 844,244.29 | 0.50% | 168,004,613.80 |
| 1-2 years | 7,597,450.56 | 3.94% | 37,987.25 | 0.50% | 7,559,463.31 |
| 2-3 years | 5,067,524.36 | 2.63% | 25,337.62 | 0.50% | 5,042,186.74 |
| Over 3 years | 2,047,029.42 | 1.06% | 32,738.07 | 0.50% | 2,014,291.35 |
| Special | 2,832,378.91 | 1.47% | 2,832,378.91 | 100.00% | — |
| Special | 6,388,057.65 | 3.31% | 5,444,320.85 | 50.00% | 943,736.80 |
| Total | <u>192,781,298.99</u> | <u>100%</u> | <u>9,217,006.99</u> | <u>—</u> | <u>183,564,292.00</u> |

- (i). Regard to 100% as doubtful debts, the Company has appealed, but the debtors are unable to perform the sentence of the Court to pay. Therefore, with the approval of the Board, the doubtful debts are considered in 100%.

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- (ii) The total debt from the top five debtors amounted to RMB166.74 million representing 73.41% of the total of account receivable. The detail situation is as follows:

| Company | Amount | Reason |
|--|-----------------------|---|
| China Shipping Development Co., Ltd. | 134,622,612.00 | Shipbuilding settlements, before the due date for payment |
| Military Site Office | 13,920,000.00 | Shipbuilding settlements, before the due date for payment |
| Zhenhua Haiwan Engineering Company Limited | 7,423,676.05 | Project Price, before the due date for payment |
| Guangdong Yuedian Jinghai Powerplate Company Limited | 6,934,651.00 | Project Price, before the due date for payment |
| National Railway No.25 Bureau, Guangzhou Branch | 3,835,566.16 | Project Price, before the due date for payment |
| Total | <u>166,736,505.21</u> | |

- (iii). None of prepayments is due from shareholders who hold 5% or above of the Company's interest.

(2). Prepayment to suppliers

| Bond Age | December 31, 2005 | | December 31, 2004 | |
|---------------|-----------------------|---------------|-----------------------|---------------|
| | Amount | Percentage % | Amount | Percentage % |
| Within 1 year | 139,871,685.48 | 82.70 | 106,549,662.30 | 94.13 |
| 1-2 years | 28,263,762.00 | 16.71 | 1,197,152.06 | 1.06 |
| 2-3 years | 953,318.83 | 0.56 | 4,700,363.63 | 4.15 |
| Over 3 years | 41,400.00 | 0.02 | 750,000.00 | 0.66 |
| Total | <u>169,130,166.31</u> | <u>100.00</u> | <u>113,197,177.99</u> | <u>100.00</u> |

- (i) Prepayment to suppliers increased by 49.41% compared with the beginning of the period, mainly due to variety of material markets and increase of prepayment for equipments and materials.

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- (ii) The amount of the five companies with highest prepayments is RMB136.13 million representing 80.48% of prepayment from customers. The details are as follows:

| Company | Amount | Reason |
|--|----------------|--|
| Dalian Marine Diesel Works | 91,650,000.00 | In 2005 material for shipbuilding is still in short supply. Subscription and prepayment are needed for most marine equipments. |
| Zhenjiang Marine Diesel Factory | 16,800,000.00 | |
| Shanxi Diesel Company | 17,316,000.00 | |
| Huanan Marine Mechanic and Electric Department | 6,467,927.85 | |
| Wuhan Marine Equipment Company | 3,894,000.00 | |
| Total | 136,127,927.85 | |

- (iii) Zhenjiang Marine Diesel Factory is a subsidiary company under CSSC and is a connected party of the Company.
- (iv) None of prepayments is due from shareholders who hold 5% or above of the Company's interest.

(3). Other receivables

| Bond age | Amount | % | December 31, 2005 | | |
|---------------|----------------|--------|------------------------------|------------------------------|----------------|
| | | | Provision for doubtful debts | Percentage of doubtful debts | Net receivable |
| Within 1 year | 4,742,514.30 | 2.13 | 23,712.57 | 0.50% | 4,718,801.73 |
| 1-2 years | 702,577.35 | 0.32 | 3,512.89 | 0.50% | 699,064.46 |
| 2-3 years | 62,619.60 | 0.03 | 313.10 | 0.50% | 62,306.50 |
| 3-4 years | 37,250.00 | 0.02 | 186.25 | 0.50% | 37,063.75 |
| 4-5 years | 217,815.00 | 0.10 | — | | 217,815.00 |
| 5 | 43,137.40 | 0.02 | 21.57 | 0.05% | 43,115.83 |
| special | 168,083,134.00 | 75.60 | 117,810,872.73 | 80.00% | 50,272,261.27 |
| special | 48,435,000.00 | 21.79 | 48,435,000.00 | 100.00% | — |
| Total | 222,324,047.65 | 100.00 | 166,273,619.10 | — | 56,050,428.55 |

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| Bond age | Amount | % | December 31, 2004 | | Net receivable |
|---------------|-----------------------|------------|------------------------------|------------------------------|----------------------|
| | | | Provision for doubtful debts | Percentage of doubtful debts | |
| Within 1 year | 13,867,193.72 | 2.99 | 69,335.97 | 0.50% | 13,797,857.75 |
| 1-2 years | 2,345,425.33 | 0.51 | 11,727.13 | 0.50% | 2,333,698.20 |
| 2-3 years | 0.00 | 0.00 | 0.00 | 0.50% | – |
| Over 3 years | 1,326,472.40 | 0.29 | 6,632.36 | 0.50% | 1,319,840.04 |
| Special | 397,067,000.00 | 85.73 | 325,374,800.00 | 80% | 71,692,200.00 |
| Special | 48,535,000.00 | 10.48 | 48,535,000.00 | 100.00% | – |
| Total | <u>463,141,091.45</u> | <u>100</u> | <u>373,997,495.46</u> | <u>–</u> | <u>89,143,595.99</u> |

- (i) The amount of the top five companies with highest other receivables is RMB216.54 million representing 97.39% of other receivables from customers. The details are as follows:

| Company | Amount | Reason |
|---|-----------------------|---------------------------------------|
| Guangzhou International Trust Investment Company | 168,083,134.00 | Trust deposit, 100% as doubtful debts |
| Guangzhou Economic and Technology Development Zone International Trust and Investment Company | 47,408,000.00 | Trust deposit, 100% as doubtful debts |
| Xiyu Investment (Hong Kong) Company | 956,000.00 | Sales of container production line |
| Cartulary of Guangzhou City | 57,600.00 | deposit |
| Yuegang Gas Industry Company Limited | <u>37,250.00</u> | deposit |
| Total | <u>216,541,984.00</u> | |

- (ii) Trust Deposits (refer to items 3 and 4 in Significant Event)

- (a) The trust deposits at Guangzhou Economic and Technology Development Zone International Trust and Investment Company ("GETDZITIC") remains RMB 47,410,000.00 with full provision for doubtful debts in 2000. With consideration of zero repayment of GETDZITIC, the decision has been made to write off in 2006 by the 10th meeting of the Board of the Company.

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(b) The trust deposits at The Company and Guangzhou International Trust Investment Company ("GZITIC") has negotiated to restructure the trust deposits in GZITIC and has changed for some assets. Comparing received and receivable realizable net value with account deposit at GZITIC, the Board of Directors proved to recover special provision for doubt debts of RMB36,171,456.15 and restructure received real estate and capital in Xinjiang. Creditor's right of RMB228,942,566.00 and special provision of doubt debts of RMB170,472,471.12 are also to be written off.

(iii) None of other receivables is due from shareholders who hold 5% or above of the Company's interest.

(4). Subsidy receivable

| Items | December 31, 2005 | December 31, 2004 |
|------------------------------------|----------------------|----------------------|
| Other subsidies | — | 38,743,592.72 |
| Value-added tax refund for exports | 34,472,851.84 | 8,886,559.24 |
| Total | <u>34,472,851.84</u> | <u>47,630,151.96</u> |

Subsidy for domestic sea going liners and value-added tax fund for exports altered largely mainly due to most new building ships are to be exported.

3. Inventories and provision for diminution in value

| Item | December 31, 2005 | | | December 31, 2004 | | |
|-----------------------|-----------------------|-----------------------------------|-----------------------|-----------------------|-----------------------------------|-----------------------|
| | Amount | Provision for diminution in value | Net amount | Amount | Provision for diminution in value | Net amount |
| Raw material | 248,487,440.10 | 995,540.89 | 247,491,899.21 | 309,139,565.31 | 949,378.29 | 308,190,187.02 |
| wrappage | — | — | — | — | — | — |
| Low-value consumables | 5,009.50 | — | 5,009.50 | 247,525.42 | — | 247,525.42 |
| Work-in-progress | 66,453,054.24 | — | 66,453,054.24 | 53,653,680.54 | — | 53,653,680.54 |
| Finished goods | 4,577,912.90 | — | 4,577,912.90 | 4,545,713.38 | 20,269.04 | 4,525,444.34 |
| Total | <u>319,523,416.74</u> | <u>995,540.89</u> | <u>318,527,875.85</u> | <u>367,586,484.65</u> | <u>969,647.33</u> | <u>366,616,837.32</u> |

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4. Deferred expenses

| Category | Opening balance | Addition in the period | Amortization in the period | Closing balance |
|--------------------------------|-----------------|------------------------|----------------------------|-----------------|
| Road maintenance and insurance | 464,439.33 | 461,420.41 | 539,224.76 | 386,634.98 |
| Property insurance | 137,212.50 | 137,662.50 | 274,875.00 | – |
| Total | 601,651.83 | 599,082.91 | 814,099.76 | 386,634.98 |

Deferred expenses were decreased by 35.74% compared with the beginning of the period mainly due to amortized road maintenance and property insurance last year.

5. Long-term investment

| Item | Opening balance | | Addition in the period | Deduction in the period | Closing balance | |
|------------------------------|-----------------|--------------------------|------------------------|-------------------------|-----------------|--------------------------|
| | Amount | Provision for diminution | | | Amount | Provision for diminution |
| Long-term equity investments | 15,807,734.42 | – | – | 72,383.60 | 15,735,350.82 | – |
| Long-term debt investments | – | – | – | – | – | – |
| Total | 15,807,734.42 | – | – | 72,383.60 | 15,735,350.82 | – |

NOTES TO THE FINANCIAL STATEMENTS

(1). Long-term equity investment – other equity investment

| Name of Investees | Total investment | Percentage holding of investees' capital | Closing balance | Equity method | |
|---|------------------|--|-----------------|----------------------|--------------------|
| | | | | Change in the period | Accumulated change |
| South China/Marine and Industrial Special Coating Limited | 1,722,060.00 | 25.00% | 2,938,945.47 | -33,517.89 | 1,216,885.47 |
| Zhanjiang Nanhai Naval New Technology & Service Co., Ltd. | 800,000.00 | 40.00% | 762,534.41 | -30,436.66 | -37,465.59 |
| Shenzhen Yuanzhou Science & Technology Industry Company Limited | 1,000,000.00 | 7.41% | 1,000,000.00 | – | – |
| China Merchants Banking Corporation | 10,010,000.00 | 0.23% | 10,010,000.00 | – | – |
| Information and Technology Company Limited of CSSC | 900,000.00 | 15.00% | 900,000.00 | – | – |
| Guangli Marine Engineering Service Company Limited | 100,000.00 | 20.00% | 123,870.94 | 23,870.94 | 23,870.94 |
| Sub-total | 14,532,060.00 | | 15,735,350.82 | -40,083.61 | 1,203,290.82 |

(2) Consolidated Difference

| Name of Investees | Opening balance | Amortization period | Balance at the beginning of the year | Amortization in the period | Value after amortization |
|-------------------------|-----------------|---------------------|--------------------------------------|----------------------------|--------------------------|
| | | | | | |
| Guangzhou Hongfan Hotel | 61,617.69 | – | 61,617.69 | 61,617.69 | – |
| Total | 61,617.69 | – | 61,617.69 | 61,617.69 | – |

NOTES TO THE FINANCIAL STATEMENTS

6. Original Cost, Accumulated Depreciation and Provision for Diminution of Fixed Assets

| Item | Opening balance | Addition | Deduction | Closing balance |
|---------------------------------------|-------------------------|-----------------------|----------------------|-------------------------|
| (1). Original Cost | | | | |
| Buildings | 437,545,590.48 | 98,036,895.54 | 3,684,568.10 | 531,897,917.92 |
| Structures | 261,684,338.97 | 325,845.24 | 10,397,984.83 | 251,612,199.38 |
| Vehicles | 25,610,343.91 | 26,770,086.00 | 2,731,512.92 | 49,648,916.99 |
| Instruments and meters | 6,412,368.91 | 147,817.66 | 191,853.86 | 6,368,332.71 |
| Transmission system | 37,157,651.43 | 1,162,571.08 | 0.00 | 38,320,222.51 |
| Machinery and equipment | 762,892,541.57 | 29,310,391.40 | 47,333,768.37 | 744,869,164.60 |
| Total | 1,531,302,835.27 | 155,753,606.92 | 64,339,688.08 | 1,622,716,754.11 |
| (2). Accumulated depreciation | | | | |
| Buildings | 102,787,432.18 | 12,044,199.18 | 1,003,627.33 | 113,828,004.03 |
| Structures | 93,012,877.28 | 9,887,689.05 | 3,201,311.03 | 99,699,255.30 |
| Vehicles | 16,739,402.25 | 22,217,245.72 | 2,419,115.33 | 36,537,532.64 |
| Instruments and meters | 4,622,986.26 | 542,190.50 | 180,761.81 | 4,984,414.95 |
| Transmission system | 16,113,296.54 | 1,949,901.46 | 0.00 | 18,063,198.00 |
| Machinery and equipment | 390,190,668.97 | 49,573,879.80 | 38,329,474.75 | 401,435,074.02 |
| Total | 623,466,663.48 | 96,215,105.71 | 45,134,290.25 | 674,547,478.94 |
| (3). Net value of fixed assets | 907,836,171.79 | 59,538,501.21 | 19,205,397.83 | 948,169,275.17 |

Fixed Assets Provision for diminution

| Item | Opening balance | Addition | Deduction | Closing balance |
|--------------|-----------------|----------|--------------|-----------------|
| Fixed Assets | 2,759,659.20 | – | 2,759,659.20 | – |

The Company has transferred its interest in the subsidiary Xinhui City Guangzhou Shipyard Nanyan Shipping Industrial Company in 2005, and wrote off relevant depreciation provision for fixed assets.

NOTES TO THE FINANCIAL STATEMENTS

7. Construction-in-process

| Category | Opening balance Including: interest | Addition in the period Including: interest | Transfer to fixed assets Including: interest | Other reductions Including: interest | Closing balance Including: interest |
|----------------------------|--|---|---|---|--|
| 1. Facilities improvements | | | | | |
| (1) Capital construction: | | | | | |
| critical improvement | | | | | |
| project in national | | | | | |
| debt | 10,039,065.97 | 32,600,497.21 | 35,092,878.78 | | 7,546,684.40 |
| Including: | | | | | |
| capitalized interests | 86,562.05 | | | | 86,562.05 |
| (2) Others | 21,014,937.51 | 66,003,634.20 | 40,547,595.27 | | 46,470,976.44 |
| 2. Subsidiaries | – | 2,407,784.64 | | | 2,407,784.64 |
| Total | <u>31,054,003.48</u> | <u>101,011,916.05</u> | <u>75,640,474.05</u> | <u>–</u> | <u>56,425,445.48</u> |
| Including: | | | | | |
| capitalized interests | 208,179.34 | – | | – | 208,179.34 |

(1) The above-mentioned critical improvement project in national debt in constructions-in-progress are the technical building, numerical plasma-cutting machine and high-efficient portal cutting machine.

(2) Capitalizing interest rate is the actual corresponding bank loan rate.

8. Intangible assets

| Category | Initial cost | Opening balance | Addition | Transfer out | Amortization | Closing balance | Remained term |
|----------------|-----------------------|----------------------|----------------------|----------------------|---------------------|----------------------|------------------|
| Land use right | 107,695,527.12 | 69,528,821.68 | – | 12,983,387.79 | 4,898,760.15 | 51,646,673.74 | 37 years |
| Know-how | 10,332,076.00 | 8,306,288.62 | 19,423,627.43 | – | 2,657,753.14 | 25,072,162.91 | 10-1 years |
| Total | <u>118,027,603.12</u> | <u>77,835,110.30</u> | <u>19,423,627.43</u> | <u>12,983,387.79</u> | <u>7,556,513.29</u> | <u>76,718,836.65</u> | |

NOTES TO THE FINANCIAL STATEMENTS

Land use right is amortized evenly over the useful lives of 50 years. Know-how is amortized evenly over a period of 10 years.

Transfer out in this period mainly is the Land right transformation arising from the interest transformation of the holding subsidiary Xinhui City Guangzhou Shipyard Nanyan Shipping Industrial Company.

9. Long-term deferred expenses

| Category | Opening balance | Addition | Amortization | Closing balance |
|--|-----------------|------------|--------------|-----------------|
| Modification expenses of fixed assets | 2,383,762.36 | 344,528.55 | 506,794.68 | 2,221,496.23 |
| Others | 2,076,883.72 | — | 718,717.72 | 1,358,166.00 |
| Total | 4,460,646.08 | 344,528.55 | 1,225,512.40 | 3,579,662.23 |

10. Short-term loans and long-term loans within one year

(1) Short-term loans

| Loans category | December 31, 2005 | December 31, 2004 | Loan's term | Note |
|-----------------|----------------------|----------------------|---------------------|-----------------------------|
| | | | | Annual interest rate (%) |
| Mortgage loans | | 82,765,000.00 | | |
| Guarantee loans | | | | |
| Credit loans | 60,354,500.00 | 33,106,000.91 | 2005.12.1~2006.3.28 | 5.32~5.42063 |
| Total | 60,354,500.00 | 115,871,000.91 | | |

Short-term loans were decreased by 47.91% compared with the beginning of the period mainly due to securing more new shipbuilding contracts and having abundance capital.

NOTES TO THE FINANCIAL STATEMENTS

(2) Long-term loans within one year

| Loans category | December 31, | December 31, | Loan's term | Note | Annual interest rate (%) |
|-----------------|----------------|----------------|---------------------|------|--------------------------|
| | 2005 | 2004 | | | |
| Mortgage loans | 200,150,000.00 | 400,000,000.00 | 2004.8.23~2006.5.31 | | 2.70 |
| Guarantee loans | — | — | | | |
| Other | | | | | |
| | | | | | |
| Total | 200,150,000.00 | 400,000,000.00 | | | |

Refer to the notes of "short-term loans" .

11. Accounts payable

(1). Bills payable

| Category | Amount | Expired within one year | Note |
|--------------------------|----------|----------------------------|------|
| Bank honored draft | — | — | |
| Commercial honored draft | — | — | |
| Total | <u>—</u> | <u>—</u> | |

Bills payable was decreased by 100% compared with the beginning of the period mainly due to good capital condition and reimburse bill in time.

During the period, the Company had no bills payable to the shareholders with equity holding at 5% or above of share capital.

NOTES TO THE FINANCIAL STATEMENTS

(2). Accounts payable

| Bond age | December 31, 2005 | | December 31, 2004 | |
|---------------|-----------------------|---------------|-----------------------|---------------|
| | Amount | Percentage% | Amount | Percentage% |
| Within 1 year | 371,858,554.78 | 99.72 | 370,757,807.37 | 99.54 |
| 1-2 years | 70,274.16 | 0.02 | 953,436.31 | 0.26 |
| 2-3 years | 446,635.96 | 0.12 | 320,269.65 | 0.09 |
| Over 3 years | 534,163.01 | 0.14 | 438,358.73 | 0.12 |
| Total | <u>372,909,627.91</u> | <u>100.00</u> | <u>372,469,872.06</u> | <u>100.00</u> |

During the period, the Company had no bills payable to the shareholders with equity holding at 5% or above of share capital.

(3). Advance payments from customers

| Category | December 31, 2005 | December 31, 2004 |
|---------------|----------------------|----------------------|
| Within 1 year | 17,378,974.84 | 13,598,296.43 |
| 1-2 years | 1,636,198.99 | 1,248,820.94 |
| 2-3 years | 515,046.41 | 60,830.00 |
| Over 3 years | 16,330.00 | — |
| Total | <u>19,546,550.24</u> | <u>14,907,947.37</u> |

Advance payments from customers increased by 31.11% mainly due to the increase of orders secured by the Company in 2005, especially the increase in steel structure and elevator business.

During the period, the Company had no advance payments from shareholders with equity holding at 5% or above of share capital.

NOTES TO THE FINANCIAL STATEMENTS

(4). Other Payables

| Category | December 31, 2005 | December 31, 2004 |
|--|----------------------|----------------------|
| Company retirement pension | – | 3,286,465.96 |
| Staff check off | 1,046,283.49 | 881,371.49 |
| Auditing expenses to auditors | 1,624,365.66 | 2,012,583.68 |
| Guangzhou Marine Affaires Bureau | 637,406.04 | 2,302,489.32 |
| Guangzhou Shipyard | – | 30,536.00 |
| Emolument to independent directors | 540,860.00 | 412,803.36 |
| Medicare for retirees | 7,299,980.62 | 10,367,169.48 |
| Deposit | 596,036.80 | – |
| Preferential expenses for retirees who only have one child or no children | 4,326,699.60 | – |
| Other payables | 11,335,216.00 | 9,813,133.60 |
| Total | <u>27,406,848.21</u> | <u>29,106,552.89</u> |
| Include: balance with over 3-year's bond age | 7,421,868.02 | 88,924.70 |

(1) The Company paid preferential treatment expenses amounting RMB4,330,000.00 to qualified retirees before December 31, 2005 according to Article 39 of Laws on Population and Family Planning of PRC. (See item 16 in Significant Events)

(2) Medicare for retirees in recent 10 years was paid by balance with over 3-year's bond age.

In the period, the Company had no advances from shareholders with equity holding at 5% or above of share capital.

12. Payable Dividends

| Category | December 31, 2005 | December 31, 2004 |
|-------------------------------------|---------------------|-------------------|
| Dividends from associated companies | <u>2,184,037.88</u> | <u>13,449.38</u> |
| Total | <u>2,184,037.88</u> | <u>13,449.38</u> |

Payable dividends was increased by 16,138.95% compared with the beginning of the period mainly due to United Steel Structures Limited declared dispatch dividends of 2004 to minority shareholder USA Haves Steel Company .

NOTES TO THE FINANCIAL STATEMENTS

13. Taxes Payable

| Category | December 31, 2005 | December 31, 2004 |
|-----------------------|-----------------------|-----------------------|
| Value-added tax | -14,807,789.99 | -21,546,664.46 |
| Sales tax | 331,072.63 | 312,761.59 |
| City construction tax | 96,723.25 | 479,238.59 |
| Income tax | 1,138,698.51 | 286,431.30 |
| Property tax | 87,831.80 | 126,226.58 |
| Land tax | 8,480.57 | -3,357.11 |
| Tax of staff income | 708,614.51 | 816,579.66 |
| Total | <u>-12,436,368.72</u> | <u>-19,528,783.85</u> |

14. Accrued expenses

| Category | December 31, 2005 | December 31, 2004 |
|--|----------------------|----------------------|
| Product warranty provision | 38,760,919.62 | 37,399,137.56 |
| Costs for outstanding projects | 27,226,240.39 | 30,994,593.31 |
| Loan interest | 62,691.39 | 168,705.25 |
| Accrued water & power cost of current months | 4,493,092.85 | 3,123,898.49 |
| Others | 5,467,122.83 | 6,015,465.44 |
| Total | <u>76,010,067.08</u> | <u>77,701,800.05</u> |

Product guarantee provision is intended to cover product maintenance costs incurred within maintain date was stated from date of delivery.

15. Other Current Liabilities

| Category | December 31, 2005 | December 31, 2004 |
|--|-----------------------|-----------------------|
| Settlement for long-term contractual project | <u>900,256,830.83</u> | <u>225,486,044.23</u> |
| Total | <u>900,256,830.83</u> | <u>225,486,044.23</u> |

Other current liabilities increased by 299.25% mainly due to the increased first payment of new shipbuilding contracts arising from the increase of new shipbuilding orders secured by the Company in 2005.

NOTES TO THE FINANCIAL STATEMENTS

16. Long-term Bank Loans

| Name of Bank | Amount | Loan's term | Annual interest rate (%) | Conditions of loans |
|------------------------------|--------|-------------|--------------------------|---------------------|
| China Import and Export Bank | — | | | |
| Total | — | | | |

Long-term bank loans decreased by 100% compared with the beginning of the period which mainly due to securing more new shipbuilding contracts and having abundance capital.

17. Special project payable

| Category | December 31, 2005 | December 31, 2004 |
|-----------------|-------------------|-------------------|
| National fund | 27,218,854.17 | 22,792,562.86 |
| Provincial fund | 2,530,000.00 | — |
| Total | 29,748,854.17 | 22,792,562.86 |

National fund of special project payable is for High Value-added Ro/Pax vessel Technology renovation project allotted in accordance with the regulation of Guo Jin Mao Tou Zi [2001]1271 issued by the State Economic and Trade Commission, the State Development Planning Commission and the Ministry of Finance.

Provincial fund is of adaptability alteration of the dry dock in accordance with the document of Yue Jin Mao Ji Shu [2004]664 issued by the Finance Department of Guangdong Province and the Economic and Trade Commission of Guangdong Province.

NOTES TO THE FINANCIAL STATEMENTS

18. Capital share

Unit: share

| Item | Opening Balance | Right issue | Bonus issue | Change (+/-) | | | Others | Sub-total | Closing Balance |
|--------------------------------|--------------------|----------------|----------------|-----------------------------|-------------------|---|--------|-----------|-----------------|
| | | | | Conversion from reserves | Addition issue | | | | |
| 1. Non-public | | | | | | | | | |
| 1) Initiator | 210,800,080.00 | - | - | - | - | - | - | - | 210,800,080.00 |
| Include: Nation | - | - | - | - | - | - | - | - | - |
| Chinese juridical person | 210,800,080.00 | - | - | - | - | - | - | - | 210,800,080.00 |
| Foreign juridical person | - | - | - | - | - | - | - | - | - |
| Other | - | - | - | - | - | - | - | - | - |
| 2) Collecting juridical person | - | - | - | - | - | - | - | - | - |
| 3) Workers | - | - | - | - | - | - | - | - | - |
| 4) Preferred stock and other | - | - | - | - | - | - | - | - | - |
| Include: transferred stock | - | - | - | - | - | - | - | - | - |
| Sub-total | 210,800,080.00 | - | - | - | - | - | - | - | 210,800,080.00 |
| 2. Public | - | - | - | - | - | - | - | - | - |
| 1) RMB common stock | 126,479,500.00 | - | - | - | - | - | - | - | 126,479,500.00 |
| 2) Foreign stock at home | - | - | - | - | - | - | - | - | - |
| 3) Foreign stock abroad | 157,398,000.00 | - | - | - | - | - | - | - | 157,398,000.00 |
| 4) Other | - | - | - | - | - | - | - | - | - |
| Sub-total | 283,877,500.00 | - | - | - | - | - | - | - | 283,877,500.00 |
| Total | 494,677,580.00 | - | - | - | - | - | - | - | 494,677,580.00 |

19. Capital reserve

| Item | Opening Balance | Addition | Deduction | Closing Balance |
|---------------|-----------------|----------|-----------|-----------------|
| Share premium | 651,977,481.72 | - | - | 651,977,481.72 |
| Total | 651,977,481.72 | - | - | 651,977,481.72 |

NOTES TO THE FINANCIAL STATEMENTS

20. Surplus reserve

| Item | Opening Balance | Addition | Deduction | Closing Balance |
|----------------------------|-----------------------|------------------|------------------|-----------------------|
| Statutory surplus reserve | 48,998,046.01 | — | — | 48,998,046.01 |
| Public welfare fund | 30,592,815.41 | — | 66,210.00 | 30,526,605.41 |
| Discretionary surplus fund | 20,556,649.92 | 66,210.00 | — | 20,622,859.92 |
| | | | | |
| Total | <u>100,147,511.34</u> | <u>66,210.00</u> | <u>66,210.00</u> | <u>100,147,511.34</u> |

The deduction of public welfare fund is for purchasing water machine for employees during this period.

21. Retained Profit

| Item | December 31, 2005 | December 31, 2004 |
|--------------------------------------|------------------------|------------------------|
| Balance at the beginning of the year | -536,539,884.17 | -570,212,867.94 |
| Balance adjustment of previous years | — | — |
| Profit of this year | 98,193,259.73 | 33,672,983.77 |
| Statutory reserve | — | — |
| Statutory public welfare fund | — | — |
| Workers welfare fund | — | — |
| Prior share dividend distributed | — | — |
| Discretionary public reserve | — | — |
| Share dividend distributed | — | — |
| | | |
| Balance at the end of the year | <u>-438,346,624.44</u> | <u>-536,539,884.17</u> |

NOTES TO THE FINANCIAL STATEMENTS

22. Geographical distribution to turnover

| Area | Principal operating incomes | | Profit | | Income changes (%) |
|------------------|-----------------------------|------------------|------------------|------------------|--------------------|
| | The year of 2005 | The year of 2004 | The year of 2005 | The year of 2004 | |
| Malta | 97,361,312.20 | 343,030,776.80 | 19,795,340.92 | 34,553,812.32 | -71.62 |
| Canada | 143,498,882.44 | – | 5,222,473.77 | – | 100.00 |
| Denmark | 1,280,913,220.96 | 1,197,260,301.32 | 78,300,458.14 | 22,567,180.12 | 7.36 |
| Macao | 25,599,082.48 | 675,709.56 | 3,619,361.07 | 161,165.40 | 3,688.47 |
| Philippine | 5,059,536.41 | 2,595,952.57 | 146,630.82 | 111,740.31 | 94.90 |
| United States | 1,020,662.89 | 85,297.60 | 343,125.48 | -30,164.17 | 1,096.59 |
| Hong Kong | 382,927,585.75 | 17,758,804.82 | 48,534,169.60 | 3,248,698.18 | 2,056.27 |
| Marshall Islands | 209,736,553.34 | – | -5,111,959.66 | – | 100.00 |
| Taiwan | 4,643,116.50 | – | 4,405,375.08 | – | 100.00 |
| Norway | 7,770,678.27 | – | -519,403.72 | – | 100.00 |
| Others | 5,251,694.21 | – | 342,378.65 | – | 100.00 |
| Sub-total | 2,163,782,325.45 | 1,561,406,842.67 | 155,077,950.15 | 60,612,432.16 | 38.58 |
| China | 565,133,754.69 | 801,995,907.85 | 62,044,655.06 | 58,002,044.67 | -29.53 |
| Total | 2,728,916,080.14 | 2,363,402,750.52 | 217,122,615.21 | 118,614,476.83 | 15.47 |

The top five customers of the Company:

| No. | Client | Percentage of principal operating income | |
|-------|--------------------------------------|--|--------|
| | | Amount | |
| 1 | China Shipping Development Co., Ltd. | 507,192,946.34 | 18.58% |
| 2 | Nortide shipping Ltd. | 488,656,167.47 | 17.91% |
| 3 | Military Site Office | 244,380,000.00 | 8.96% |
| 4 | A.P.Moller-maersk | 211,914,023.62 | 7.77% |
| 5 | Emeroldshipping Limited, Malta | 97,034,831.72 | 3.56% |
| Total | | 1,549,177,969.15 | 56.77% |

NOTES TO THE FINANCIAL STATEMENTS

23. Principal operating incomes, cost of sales and gross profit

| Item | Operating income | | Operating cost | | Operating gross profit | |
|-------------------------|-------------------------|-------------------------|-------------------------|-------------------------|------------------------|-----------------------|
| | This period | Last period | This period | Last period | This period | Last period |
| Shipbuilding products | 2,335,531,197.24 | 2,105,611,528.25 | 2,168,909,240.91 | 2,037,134,355.79 | 166,621,956.33 | 68,477,172.46 |
| Container manufacturing | – | 1,133,080.23 | – | 800,441.12 | – | 332,639.11 |
| Steel structures | 287,657,617.19 | 140,961,939.86 | 264,532,458.20 | 128,159,600.15 | 23,125,158.99 | 12,802,339.71 |
| Terrestrial machinery | 98,733,719.31 | 100,444,374.78 | 71,926,963.92 | 66,582,598.26 | 26,806,755.39 | 33,861,776.52 |
| Ship-repairing products | 6,993,546.40 | 15,251,827.40 | 6,424,801.90 | 12,111,278.37 | 568,744.50 | 3,140,549.03 |
| Total | <u>2,728,916,080.14</u> | <u>2,363,402,750.52</u> | <u>2,511,793,464.93</u> | <u>2,244,788,273.69</u> | <u>217,122,615.21</u> | <u>118,614,476.83</u> |

Principal operating incomes is increased by 15.47% compared with that of the corresponding period of last year mainly due to the increased of shipbuilding and steel structure businesses. Gross profit is increased by 83.05% mainly due to the shipbuilding production resuming continuation and balance. Vessels being built are mainly secured since 2003 and the prices are increased compared with last year. To overcome the negative price rising of raw material and appreciation of exchange rate of RMB to USD and ensure maximum integral profit, the Company actively promotes achievement and efficiency management and shipbuilding mode transformation and reinforces the cost control and management to escalate shipbuilding efficiency and profit. Besides, the steel structure business also achieved great success with higher benefit ability in this period mainly due to the cost control.

24. Principal operating tax and additional tax

| Category | The year of 2005 | The year of 2004 |
|--------------------------|---------------------|---------------------|
| Sales tax | 690,733.55 | 918,803.88 |
| City construction tax | 870,577.66 | 715,643.74 |
| Education additional tax | <u>372,539.84</u> | <u>319,553.04</u> |
| Total | <u>1,933,851.05</u> | <u>1,954,000.66</u> |

NOTES TO THE FINANCIAL STATEMENTS

25. Financial expenses

| Category | The year of 2005 | The year of 2004 |
|-----------------------|----------------------|---------------------|
| Interest expense | 19,087,141.74 | 19,512,715.14 |
| Less: interest income | 4,936,637.85 | 7,257,712.56 |
| exchange loss | 16,019,272.91 | -4,531,595.54 |
| Others | 2,499,508.74 | 1,436,745.41 |
| Total | <u>32,669,285.54</u> | <u>9,160,152.45</u> |

The financial expenses decreased by 256.65% mainly due to appreciation of exchange rate of RMB to USD, which made the increase in exchange loss.

26. Operation and management expenses

| Item | The year of 2005 | The year of 2004 |
|------------------------|-----------------------|-----------------------|
| 1. Operation expenses | 4,067,459.64 | 2,596,263.10 |
| 2. Management expenses | <u>117,196,183.27</u> | <u>143,506,434.08</u> |

The operation expense increased by 56.67% over that of last year mainly due to more operation activity.

27. Profit from other operations

| Item | Operating income | | Operating cost | | Operating gross profit | |
|--------------------------|----------------------|----------------------|----------------------|----------------------|------------------------|----------------------|
| | The year of 2005 | The year of 2004 | The year of 2005 | The year of 2004 | The year of 2005 | The year of 2004 |
| Sales of raw materials | 25,895,881.13 | 26,823,407.60 | 25,006,031.63 | 22,950,604.76 | 889,849.50 | 3,872,802.84 |
| Sales of scrap materials | 36,034,563.74 | 24,441,964.67 | 24,852,642.08 | 17,907,066.43 | 11,181,921.66 | 6,534,898.24 |
| Transportation service | 138,615.60 | 1,510,796.27 | 136,996.55 | 230,186.37 | 1,619.05 | 1,280,609.90 |
| Leasehold | 1,348,581.08 | 7,290,294.72 | 1,464,894.98 | 1,634,042.58 | -116,313.90 | 5,656,252.14 |
| Others | 33,990,315.18 | 10,007,947.72 | 28,095,538.43 | 12,111,884.30 | 5,894,776.75 | -2,103,936.58 |
| Total | <u>97,407,956.73</u> | <u>70,074,410.98</u> | <u>79,556,103.67</u> | <u>54,833,784.44</u> | <u>17,851,853.06</u> | <u>15,240,626.54</u> |

NOTES TO THE FINANCIAL STATEMENTS

28. Investment income

| Item | Bonds investment | Equity investments | | Total income |
|------------------------|------------------|--------------------|------------|--------------|
| | | At equity | At cost | |
| Short-term investments | | | — | — |
| Long-term investments | | 438,059.78 | 891,085.80 | 1,329,145.58 |
| Total | — | 438,059.78 | 891,085.80 | 1,329,145.58 |

The investment income increased by 556.55% over that of last year mainly due to the benefit from affiliates of the Company increased.

29. Subsidy income

| Item | The year of 2005 | The year of 2004 |
|------------------------------|------------------|------------------|
| Subsidy for sea going liners | 21,888,006.00 | 57,511,102.55 |
| Others | 4,005,977.17 | 3,477,465.86 |
| Total | 25,893,983.17 | 60,988,568.41 |

The subsidy income in this year decreased by 57.54%, mainly due to the decreased subsidy income for domestic sea going vessels, which arising from that more ships were built for export during the period.

- (1) Subsidy for sea going liners is a subsidy for 40,000 dwt product oil tankers built for a domestic client, which are eligible for special financial subsidy in according to relevant national regulations. The income is calculated by completion percentage and certain proportion to schedule settlement in accordance with Cai Kuai Zi [2000] 3 issued by Ministry of Finance.
- (2) Other subsidies consist of the reception of special subsidies for scientific trading and drawback of self-developed software.

NOTES TO THE FINANCIAL STATEMENTS

30. Non-operating income and expenses

(1) Non-operating income

| Iteam | The year of 2005 | The year of 2004 |
|----------------------------------|---------------------|---------------------|
| Gain on disposal of fixed assets | 803,336.54 | 5,488,546.57 |
| Penalty received | 40,948.00 | 54,409.43 |
| Income of fixed assets | — | — |
| Compensation | 10,149.27 | 45,315.10 |
| Bad debt income | — | 8,200.00 |
| Others | 3,509,130.89 | 423,934.84 |
| Total | <u>4,363,564.70</u> | <u>6,020,405.94</u> |

Non-operating income decreased by 27.52% compared with that of the corresponding period of last year mainly due to decreased gain on disposal of part fixed assets.

(2) Non-operating expenses

| Category | The year of 2005 | The year of 2004 |
|----------------------------------|---------------------|----------------------|
| Loss on disposal of fixed assets | 3,311,400.21 | 5,209,592.14 |
| Penalty expenses | 29,646.56 | 6,550.00 |
| Loss on fixed assets | 304,649.32 | 72,352.49 |
| Compensation | 146,668.65 | 429,827.84 |
| Non-commonweal sponsor | 110,300.00 | 100,000.00 |
| Others | 1,513,726.71 | 4,611,445.96 |
| Total | <u>5,416,391.45</u> | <u>10,429,768.43</u> |

Non-operating expenses decreased by 48.07% compared with that of the corresponding period of last year mainly due to decreased loss on disposal of part fixed assets.

NOTES TO THE FINANCIAL STATEMENTS

31. Exceptional items

| Category | Amount |
|--|----------------------|
| 1. Subsidy income (excluding the subsidy income of domestical sea going liner) | 4,005,977.17 |
| 2. Non-operating income | 4,363,564.70 |
| 3. Writing back bad debts provision (Note 1) | 36,171,456.15 |
| 4. Writing back bad debts provision of subsidiary (Note 2) | 1,369,320.66 |
| 5. Preferential expenses of retirees who only have one child or no children (Note 3) | -4,326,699.60 |
| 6. Non-operating expenses | -5,416,391.45 |
| Total | <u>36,167,227.63</u> |

Note:

- The adjustment was made for the realizable value of relevant assets that have been restructured and will be restructured in accordance with the debts restructuring agreement entered into between the Company and GZITIC.
- The writing back adjustment is made in accordance with the debt settlement plan entered into between United Steel Structure Limited, a subsidiary of the Company, and Havens Steel Company, an other shareholder of United Steel Structure Limited.
- The preferential expenses for retirees who only have one child or no children and retired before December 31, 2005, which amounting RMB4,326,699.60 and recorded in the year 2005, is in accordance with Article 39 of Laws on Population and Family Planning of PRC and under approval of the Board of Directors of the Company. The preferential expenses are calculated on relevant proportion of the average wage of Guangzhou City, and have different standards for different retiring dates. The regulation above-mentioned has been considered and approved at Standing Committee of the People's Congress of Guangzhou Municipal, and is regarded as legal obligation of enterprises in Guangzhou.

32. Other main expenses related to business

| Item | Amount (RMB) |
|----------------------|-----------------------|
| Management expenses | 33,498,254.36 |
| Operating expenses | 4,067,459.64 |
| Manufacture expenses | <u>273,445,521.81</u> |
| Total | <u>311,011,235.81</u> |

NOTES TO THE FINANCIAL STATEMENTS

33. Notes to the major items of financial statements of the parent company

(1) Accounts receivable

| December 31, 2005 | | | | |
|-------------------|----------------|------------|------------------------------|----------------|
| Age bond | Amount | Proportion | Provision for doubtful debts | Record value |
| Within one year | 183,247,898.52 | 86.56 | 916,239.49 | 182,331,659.03 |
| 1-2 years | 918,153.75 | 0.43 | 4,590.77 | 913,562.98 |
| 2-3 years | 20,143,970.35 | 9.52 | 100,719.85 | 20,043,250.50 |
| 3-4 years | 2,662,263.51 | 1.26 | 13,311.32 | 2,648,952.19 |
| 4-5 years | 90,000.00 | 0.04 | 450.00 | 89,550.00 |
| special | 4,628,635.79 | 2.19 | 4,628,635.79 | – |
| Total | 211,690,921.92 | 100.00 | 5,663,947.22 | 206,026,974.70 |

| December 31, 2004 | | | | |
|-------------------|----------------|------------|------------------------------|----------------|
| Age bond | Amount | Proportion | Provision for doubtful debts | Record value |
| Within one year | 148,041,125.72 | 93.44 | 740,205.63 | 147,300,920.09 |
| 1-2 years | 366,230.00 | 0.23 | 1,831.15 | 364,398.85 |
| 2-3 years | 3,325,778.06 | 2.10 | 16,628.89 | 3,309,149.17 |
| Over 3 years | 1,986,092.07 | 1.25 | 9,930.46 | 1,976,161.61 |
| Special | 2,832,378.91 | 1.79 | 2,832,378.91 | – |
| Special | 1,887,473.62 | 1.19 | 943,736.81 | 943,736.81 |
| Total | 158,439,078.38 | 100.00 | 4,544,711.85 | 153,894,366.53 |

Refer to the notes of “Accounts Receivable”.

None of accounts receivables is due from shareholders who hold 5% or above of the company's shares.

NOTES TO THE FINANCIAL STATEMENTS

(2) Other accounts receivable

December 31, 2005

| Age bond | Amount | Proportion | Provision for doubtful debts | Record value |
|-----------------|----------------|------------|------------------------------|---------------|
| Within one year | 4,959,868.45 | 2.22 | 24,799.34 | 4,935,069.11 |
| 1-2 years | 2,234,768.06 | 1.00 | 11,173.84 | 2,223,594.22 |
| 2-3 years | 426,602.57 | 0.19 | 2,133.01 | 424,469.56 |
| 3-4 years | 15,000.00 | 0.01 | 75.00 | 14,925.00 |
| 4-5 years | — | 0.00 | — | — |
| special | 215,518,134.00 | 96.58 | 165,245,872.73 | 50,272,261.27 |
| Total | 223,154,373.08 | 100.00 | 165,284,053.93 | 57,870,319.15 |

December 31, 2004

| Age bond | Amount | Proportion | Provision for doubtful debts | Record value |
|------------------------|----------------|------------|------------------------------|---------------|
| Within one year | 15,727,556.32 | 3.40 | 78,637.78 | 15,648,918.54 |
| 1-2 years | 1,561,301.08 | 0.34 | 7,806.51 | 1,553,494.57 |
| 2-3 years | — | 0.00 | — | — |
| Over 3 years | 313,935.00 | 0.07 | 1,569.68 | 312,365.33 |
| 80% as doubtful debts | 397,067,000.00 | 85.91 | 325,374,800.00 | 71,692,200.00 |
| 100% as doubtful debts | 47,535,000.00 | 10.28 | 47,535,000.00 | — |
| Total | 462,204,792.40 | 100.00 | 372,997,813.96 | 89,206,978.44 |

None of accounts receivables is due from shareholders who hold 5% or above of the company's shares.

(3) Long-term Investments

| Item | Opening Balance | | | Closing Balance | | |
|------------------------------|-----------------|-----------------------------------|------------------------|-------------------------|----------------|-----------------------------------|
| | Amount | Provision for diminution in value | Addition in the period | Deduction in the period | Amount | Provision for diminution in value |
| Long-term equity investments | 124,258,275.76 | 1,828,163.97 | 4,760,802.89 | 15,534,726.21 | 113,484,352.44 | |
| Long-term debt investments | — | — | — | — | — | — |
| Total | 124,258,275.76 | 1,828,163.97 | 4,760,802.89 | 15,534,726.21 | 113,484,352.44 | — |

NOTES TO THE FINANCIAL STATEMENTS

Long-term equity investments – Other equity investments

| Name of Investees | Total investment | Percentage holding of investees' capital | Closing Balance | Change in the period | Accumulated change |
|--|------------------|--|-----------------|----------------------|--------------------|
| Guangzhou Masterwood Company Limited | 932,943.00 | 51% | 3,099,842.35 | 178,115.19 | 2,166,899.35 |
| Guangzhou Guanglian Container Transportation Company Limited | 15,000,000.00 | 75% | 14,124,856.70 | -1,451,844.65 | -875,143.30 |
| Xinhui City Nanyang Shipping Industrial Company | 25,200,000.00 | 70% | 0 | -15,351,163.97 | -25,200,000.00 |
| Guangzhou Sanlong Industrial Trading Develop Company Limited | 1,005,000.00 | 67% | 0 | -32,300.00 | -1,005,000.00 |
| Guangzhou Xinsun Shipping Service Company Limited | 500,000.00 | 83% | 10,569,730.15 | 699,303.58 | 10,069,730.15 |
| United Steel Structures Limited | 25,438,698.00 | 51% | 41,257,430.16 | 2,869,394.36 | 15,818,732.16 |
| Guangdong GSI Elevator Limited | 19,950,000.00 | 95% | 22,547,829.30 | 1,382,720.03 | 2,597,829.30 |
| Guangzhou Hongfan Information Technique Co., Ltd | 4,500,000.00 | 77% | 4,727,527.58 | 441,093.88 | 227,527.58 |
| Rongguang Develop Company Limited | 10,439.94 | 100% | 2,445,656.32 | 554,712.81 | 2,435,216.38 |
| South China/Marine and Industrial Special Coating Limited | 1,722,003.00 | 25% | 2,938,945.47 | -33,517.89 | 1,216,942.47 |
| Zhanjiang Nanhai Naval Ships High and New Technology Service Co. Ltd | 800,000.00 | 40% | 762,534.41 | -30,436.66 | -37,465.59 |
| Shenzhen Yuanzhou Science & Technology Industry Company Ltd | 1,000,000.00 | 7% | 1,000,000.00 | – | – |
| China Merchants Bank | 10,010,000.00 | 0% | 10,010,000.00 | – | – |
| Total | 106,069,083.94 | | 113,484,352.44 | -10,273,923.32 | 7,415,268.50 |

The 70% interest in Xinhui City Guangzhou Shipyard Nanyang Shipping Industrial Company of the Company has been transferred to an investor by RMB13.52 million with an agreement signed on February 25, 2005. The transfer fund was received on March 9, 2005 and relevant account treatment for the transferring has finished in 2005.

NOTES TO THE FINANCIAL STATEMENTS

(4) Investment income

| Item | Bonds investment income | Equity investment | | Total income |
|------------------------|----------------------------|-------------------|------------|--------------|
| | | At equity | At cost | |
| Short-term Investments | – | – | – | – |
| Long-term investments | – | 7,463,719.12 | 891,085.80 | 8,354,804.92 |
| Total | – | 7,463,719.12 | 891,085.80 | 8,354,804.92 |

(5) Principal operating income, cost and gross profit

| Product Category | Operating income | | Operating Cost | | Operating Gross profit | |
|-------------------------|------------------|------------------|------------------|------------------|------------------------|------------------|
| | The year of 2005 | The year of 2004 | The year of 2005 | The year of 2004 | The year of 2005 | The year of 2004 |
| Shipbuilding products | 2,335,531,197.24 | 2,105,611,528.25 | 2,168,909,240.91 | 2,037,134,355.79 | 166,621,956.33 | 68,477,172.46 |
| Steel Structures | 76,168,239.05 | 34,514,326.73 | 70,974,549.74 | 32,896,081.75 | 5,193,689.31 | 1,618,244.98 |
| Terrestrial machinery | 45,558,655.58 | 45,566,123.10 | 36,790,491.26 | 35,074,206.60 | 8,768,164.32 | 10,491,916.50 |
| Ship-repairing products | 6,993,546.40 | 15,251,827.40 | 6,424,801.90 | 12,111,278.37 | 568,744.50 | 3,140,549.03 |
| Total | 2,464,251,638.27 | 2,200,943,805.48 | 2,283,099,083.81 | 2,117,215,922.51 | 181,152,554.46 | 83,727,882.97 |

Refer to relevant note in the Consolidated Statements.

NOTES TO THE FINANCIAL STATEMENTS

(VI). CONNECTED PARTY AND TRANSACTIONS

1. Connected parties under the control of the Company

| Name | Registered address | Principal Business | Relationship With the Company | Nature of the Enterprise | Legal Representative |
|--|---|---|-------------------------------------|-----------------------------------|-------------------------|
| CSSC | No. 1 Pudong main Road, Shanghai | Ship manufacturing And sales | State Shareholder | Company with Limited liability | Chen Xiaojin |
| Guangzhou Xinsun Shipping Service Company Limited | No.40 Fangcun Main Road Guangzhou | Installation, welding Outfitting, coating, Repair of hull structure | Subsidiary | Company with Limited liability | Zhou Dusheng |
| Masterwood Company Limited | No.40 Fangcun Main Road Guangzhou | Manufacture furniture | Subsidiary | Sino-foreign Joint Venture | Chen Demin |
| Guangzhou Guanglian Container Transportation Company Limited | No.126 Gexin Road Guangzhou | Container Transportation | Subsidiary | Sino-foreign Joint Venture | Wang Lijian |
| Xinhui City Nanyang Shipping Industrial Co. | Gujin Town, Xinhui City, Guangdong | Ship dismantling | Subsidiary | Cooperative Company | Li Yizhen |
| United Steel Structures Limited | No.40 Fangcun Main Road Guangzhou | Steel Structure business | Subsidiary | Sino-foreign Joint Venture | Chen Jianrong |
| Guangdong GSI Elevator Limited | No.40 Fangcun Main Road Guangzhou | Manufacturing elevator | Subsidiary | Company with Limited liability | Lin Liangguang |
| Guangzhou Hongfan Information Technique Co., Ltd | No.40 Fangcun Main Road Guangzhou | Development of computer Software, system integration and sales. | Subsidiary | Cooperative Company | Wang Lijian |
| Glory Group Developing Co., Ltd. | Catic plaza 8 causeway rd causeway bay, HK | General Trading | Subsidiary | Cooperative Company | Han Guangde |
| Connected parties under indirect control: | | | | | |
| Guangzhou Hongfa Hotel | No.126 Gexin Road Guangzhou | Lodge, restaurant | Subsidiary | Cooperative Company | Wang Lijian |
| Fankwong Developing Zeng Xiangxin Co., Ltd. | Catic plaza 8 causeway rd Causeway bay, HK | General Trading | Subsidiary | Cooperative Company | Zeng Xiangxin |
| Guangzhou Masterwood Co., Ltd. | 40 Fangcun Main Road, Guangzhou | Furniture manufacturing | Subsidiary | Sino-foreign Joint Venture | Chen Demin |

NOTES TO THE FINANCIAL STATEMENTS

2. The registered capital of connected parties under the control of the Company and their changes

| Name | Opening Balance <i>RMB</i> | Additions in the period <i>RMB</i> | Disposal in the period <i>RMB</i> | Closing Balance <i>RMB</i> |
|---|-------------------------------|--|---|----------------------------------|
| CSSC | 6,374,300,000 | – | – | 6,374,300,000 |
| Guangzhou Xinshun Shipping Service Company Limited | 2,000,000 | – | – | 2,000,000 |
| Masterwood Company Limited | 3,315,180 | – | – | 3,315,180 |
| Guangzhou Guanglian Container Transportation Co., Ltd. | 20,000,000 | – | – | 20,000,000 |
| Xinhui City Nanyang Shipping Industrial Company | 34,800,000 | – | 34,800,000 | 0 |
| United Steel Structures Limited | 73,572,705 | – | – | 73,572,705 |
| Guangdong GSI Elevator Limited | 21,000,000 | – | – | 21,000,000 |
| Guangzhou Hongfan Information Technique Co., Ltd | 5,000,000 | – | – | 5,000,000 |
| Glory Group Developing Co.,Ltd. | HKD10,000 | | | HKD10,000 |
| Connected parties under indirect control: | | | | |
| Guangzhou Hongfa Hotel | 10,000,000 | – | – | 10,000,000 |
| Fankwong Developing Co., Ltd. | HKD200,000 | – | – | HKD200,000 |
| Masterwood Company Limited | 3,315,180 | – | – | 3,315,180 |

NOTES TO THE FINANCIAL STATEMENTS

3. The equity interests in connected parties under the control of the Company and their changes

| Name | Opening Balance | | Additions in the period | | Disposal in the period | | Closing Balance | |
|--|-----------------|-------|-------------------------|--|------------------------|--|-----------------|-------|
| | RMB | % | RMB | | RMB | | RMB | % |
| CSSC | 210,800,080.00 | 42.61 | – | | | | 210,800,080.00 | 42.61 |
| Guangzhou Xinshun Shipping Service Co., Ltd. | 11,665,807.39 | 83 | 1,068,807.25 | | | | 12,734,614.64 | 83 |
| Masterwood Company Limited | 5,728,876.78 | 51 | 349,245.47 | | | | 6,078,122.25 | 51 |
| Guangzhou Guanglian Container Transportation Company Limited | 20,768,935.14 | 75 | | | 1,935,792.88 | | 18,833,142.26 | 75 |
| Xinhui City Nanyang Shipping Industrial Co. | 20,730,234.24 | 70 | | | 20,730,234.24 | | – | |
| United Steel Structures Limited | 79,771,242.46 | 51 | 6,173,331.29 | | 5,047,651.87 | | 80,896,921.88 | 51 |
| Guangdong GSI Elevator Limited | 22,279,062.39 | 95 | 1,455,494.77 | | | | 23,734,557.16 | 95 |
| Guangzhou Hongfan Information Technique Co., Ltd | 5,566,797.02 | 77 | 572,849.19 | | | | 6,139,646.21 | 77 |
| Glory Group Developing Co.,Ltd | 1,890,943.51 | 98 | 554,712.81 | | | | 2,445,656.32 | 98 |
| Connected parties under indirect control: | | | | | | | | |
| Guangzhou Hongfa Hotel | 3,332,276.45 | 86.16 | | | | | 3,332,276.45 | 86.16 |
| Fankwong Developing Co., Ltd. | HKD200,000 | 70 | 0 | | | | | 70 |
| Masterwood Company Limited | 5,728,876.78 | 25 | 349,245.47 | | | | 6,078,122.25 | 25 |

The connected transactions under the control of the company had been counteracted in the consolidated financial statement.

4. The condition of the connected parties uncontrolled by the Company

(1) The connected parties uncontrolled by the Company

The connected transactions made between the Group and the associated enterprises under CSSC or associated enterprises and under the Group during the year had been carried out in the ordinary course of business of the relevant companies and on normal commercial terms, and had been entered into in accordance with the terms of the agreement covering such transactions or (where there is no such agreement) on terms no less favorable which are fair and reasonable as far as the shareholders are concerned.

NOTES TO THE FINANCIAL STATEMENTS

Affiliated company

South China Marine & Industrial Special Coating Company Limited
Guangzhou Guangli Marine Engineering Service Co., Ltd.

Companies under control of China State Shipbuilding Corporation

| | |
|---|--|
| CSSC No. 708 Institute | Guangzhou Shipyard |
| Guangzhou Wenchong Shipyard | Huanan Marine Mechanic and Electric Department |
| Guangzhou Huangpu Shipyard | Hudong Heavy Engineering Company Limited |
| Shanghai Navigation Instrument Factory | No.9 Design Institution of CSSC |
| CSSC International Trade Co., Ltd | Zhenjiang Marine Diesel Factory |
| Nanjing Liuzhou Machinery Factory | Zhenjiang Marine Auxiliary Machine Factory |
| Zhengmao Group Company Limited | Zhenjiang Marine Propeller Factory |
| Jiangxi Chaoyang Machine Factory | China Shipping Trading Corporation |
| Gaungzhou Administrative Bureau | China State Shipbuilding Corporation |
| Hudong Zhonghua Shipyard (Group Limited company) | Guangzhou Shipyard Guangda Company (a subsidiary of Guangzhou Shipyard) |
| Jiujiang Marine Mechanical Factory | Anqing Marine Electric Factory |
| Jiujiang Instrument Factory | Jiangxi Marine Valve Factory |
| Huahai Marine Commodity Logistic Company | CSSC Finance Co., Ltd. |
| Guangxi Guijiang Shipyard | Shanghai Hudong Shipyard Valve Co., Ltd. |
| CSSC System Engineering Department | Guangzhou Shipyard Forging Co., Ltd. |
| CSSC Guanzhou Holding Company | China United Shipbuilding Co., Ltd, Hong Kong |
| No.611 Institute, Shanghai Sanjing Technology Co., Ltd. | Jiangxi Navigation Instrument Factory |
| Anqing Marine Diesel Factory | CSSC Luzhou Environment Protection Equipment Co., Ltd |
| Chenxi Shipbuilding and Shiprepairing Factory | Shanghai Shipyard |
| Hudong Corporation Electric Division | Haiyin Limited Company |

NOTES TO THE FINANCIAL STATEMENTS

(2) Material and labor provided by CSSC to the Company (RMB)

| Connected Parties | Total | The year of 2005 | | | The year of 2004 | |
|---|---------------|------------------|--------------|----------------|------------------------------|---------------|
| | | Power | Material | Operating Rent | Labour and Technical Service | |
| Affiliated Company | | – | – | – | – | |
| South China Marine & Industrial Special Coating Company Limited | 33,456.63 | 12,355.24 | 13,628.61 | | 7,472.78 | 20,715.06 |
| sub-total | 33,456.63 | 12,355.24 | 13,628.61 | – | 7,472.78 | 20,715.06 |
| Companies under control of CSSC | | | | | | |
| Guangzhou Shipyard Guangda Co. | – | | | | | 1,672,650.67 |
| Guangzhou Shipyard Forging Co., Ltd | 93,141.86 | | | | 93,141.86 | 144,790.16 |
| Guangxi Guijiang Shipyard | – | | | | | 163,787.42 |
| Guangzhou Huangpu Shipyard | 1,774,286.44 | | 1,279,422.49 | 5,000.16 | 489,863.79 | 1,784,809.08 |
| Guangzhou Naval Vessels & Marine Design & Research Institute | – | | | | | – |
| Guangzhou Wenchong Shipyard | 13,545,488.27 | | 7,065.81 | 683,757.00 | 12,854,665.46 | 13,266,500.86 |
| Guangzhou Shipyard | 6,895,139.55 | 3,108,589.75 | 2,593,649.62 | 111,700.80 | 1,081,199.38 | 3,250,448.18 |
| CSSC Guangzhou Holding Co. | – | | | | | 1,810.00 |
| Huanan Marine Mechanic and Electric Department | – | | | | | 953,681.20 |
| Nanjing CSSC Lvzhou Environment Protection Equipment Co., Ltd. | – | | | | | 1,153.77 |
| CSSC System Engineering Department | – | | | | | 900.00 |
| CSSC (cadre) | 29,487.18 | | 29,487.18 | | | |
| Chian Shipping Trading Corporation | 203,230.00 | | 203,230.00 | | | – |
| Sub-total | 22,540,773.30 | 3,108,589.75 | 4,112,855.10 | 800,457.96 | 14,518,870.49 | 21,240,531.34 |
| Total | 22,574,229.93 | 3,120,944.99 | 4,126,483.71 | 800,457.96 | 14,526,343.27 | 21,261,246.40 |

NOTES TO THE FINANCIAL STATEMENTS

Material and Labor provided by CSSC to the Company

| Related companies | Total | The year of 2005 | | | The year of 2004 | |
|--|---------------|----------------------|------------------|----------------------|------------------------------|---------------|
| | | Purchasing materials | Marine equipment | Production equipment | Labour and technical service | |
| South China/Maring and Industrial | | | | | | |
| Special Coating Limited | 85,000.00 | – | – | – | 85,000.00 | – |
| Guangzhou Guangli Marine Engineering | | | | | | |
| Service Co., Ltd. | 30,466,209.67 | – | – | – | 30,466,209.67 | – |
| Huahai marine Commodity Logistic Co. | – | – | – | – | – | 257,334.29 |
| 611 Institute Shanghai Sanjing | | | | | | |
| Technology Co., Ltd. | – | – | – | – | – | 2,672,780.00 |
| CSSC No. 708 Institute | 1,773,500.00 | – | – | – | 1,773,500.00 | 2,022,960.00 |
| Anqing Marine Diesel Factory | 2,450.00 | – | – | – | 2,450.00 | – |
| Anqing marine Electric Equipment Factory | 143,400.00 | – | – | 143,400.00 | – | 213,199.00 |
| Chenxi Shiprepairing Factory | – | – | – | – | – | 77,997.60 |
| Guangzhou Shipyard Guangda Co. | – | – | – | – | – | 32,964,664.37 |
| Guangzhou Shipyard Forging Co., Ltd. | 17,793,928.27 | 375,708.68 | 17,418,219.59 | – | – | 4,971,909.71 |
| Guangxi Guijiang Shipyard | 1,280,000.00 | – | – | 1,280,000.00 | – | – |
| Guangzhou Huangpu Shipyard | 565,036.80 | 924.66 | – | – | 564,112.14 | 459,735.81 |
| Guangzhou Wenchong Shipyard | 4,468,875.05 | – | – | – | 4,468,875.05 | 3,038,665.95 |
| Guangzhou Shipyard | 66,845,185.27 | 9,680,578.50 | 23,601,208.18 | 93,118.42 | 33,470,280.17 | 38,882,648.82 |
| Huanan Marine Mechanical Factory | 9,023,415.51 | – | – | 9,023,415.51 | – | 4,966,989.33 |
| Haiyin Co. | 686,500.00 | – | – | – | – | 686,500.00 |
| Hudong Group Electrical Factory | 1,305,000.00 | – | – | 1,305,000.00 | – | 485,000.00 |
| Hudong Heavy Mechanical Co., Ltd. | 14,672,410.26 | – | – | 14,672,410.26 | – | 15,783,060.00 |
| Jiangxi Chaoyan Mechanical Factory | 1,923,895.41 | – | 1,923,895.41 | – | – | 4,014,385.37 |
| Jiangxi Marine Valve Factory | – | – | – | – | – | 452,070.00 |
| Jiangxi Navigation Instrument Factory | 980.00 | – | – | 980.00 | – | 2,350.00 |
| Jiujiang Marine Mechanical Factory | 3,481,580.68 | – | 3,470,092.68 | 11,488.00 | – | 4,861,560.36 |
| Junjian Instrument Factory | 245,000.00 | – | – | 245,000.00 | – | 260,000.00 |
| Nanjing Lvzhou Mechanical Factory | 4,025,641.02 | – | – | 4,025,641.02 | – | 6,070,750.43 |
| Nanjing Lvzhou Environment Protect | | | | | | |
| Equipment Co., Ltd. | 1,726,632.49 | – | – | 1,726,632.49 | – | 2,118,900.00 |
| Shanghai Navigation Instrument | | | | | | |
| General Factory | 326,300.00 | – | – | 326,300.00 | – | 523,000.00 |

NOTES TO THE FINANCIAL STATEMENTS

| Related companies | Total | The year of 2005 | | | The year of 2004 | |
|--|-----------------------|----------------------|----------------------|-----------------------|------------------------------|-----------------------|
| | | Purchasing materials | Marine equipment | Production equipment | Labour and technical service | |
| Shanghai Hudong Shipbuilding Valve Co., Ltd. | 287,467.36 | - | 287,467.36 | - | - | 60,566.73 |
| Zhenjiang marine Auxiliary Machine Factory | 4,601,068.39 | - | - | 4,601,068.39 | - | 4,760,725.34 |
| Zhenjiang Marine Propeller Factory | - | - | - | - | - | 1,206,090.00 |
| Zhenjiang Marine Diesel Factory | 63,119,042.59 | - | - | 63,119,042.59 | - | 34,855,013.38 |
| Zhenmao Group Co., Ltd. | 521,367.52 | - | 521,367.52 | - | - | 3,022,437.00 |
| China State International Trading Co. | 70,370.51 | 70,370.51 | - | - | - | 944,655.86 |
| CSSC | - | - | - | - | - | 19,647.73 |
| CSSC No. 9 Design Institute | 565,000.00 | - | - | - | 565,000.00 | - |
| CSSC System Engineering Department | - | - | - | - | - | 846,154.00 |
| Total | <u>230,005,256.75</u> | <u>10,127,582.35</u> | <u>47,222,250.74</u> | <u>101,259,996.68</u> | <u>71,395,426.98</u> | <u>170,815,251.08</u> |

Pursuant to the comprehensive service agreement and its supplementary agreement entered between the Company and Guangzhou Shipyard in the previous years, the Company paid the comprehensive service fee with a total amount of RMB7,328,089.30 during the period under review. Please refer to Note 38 on page 191.

(4) Finance Service Provided by CSSC

| Item | Close balance | | Interest received/paid | |
|---------------------------|-------------------------|----------------------------|------------------------|------------------|
| | As at December 31, 2005 | As at December 31, of 2004 | The year of 2005 | The year of 2004 |
| 1. Deposit | | | | |
| CSSC Finance Company Ltd. | <u>928,326.17</u> | <u>1,852,930.75</u> | <u>7,510.88</u> | <u>75,400.13</u> |
| 2. Loan | | | | |
| CSSC Finance Company Ltd. | <u>-</u> | <u>-</u> | <u>-</u> | <u>-</u> |

NOTES TO THE FINANCIAL STATEMENTS

(5) Assurance provided by CSSC and the assurance fee

| Company | Amount of Guarantee | | Guarantee fee paid by the Company | |
|----------------------------|-----------------------|-----------------------|-----------------------------------|---------------------|
| | The year of 2005 | The year of 2004 | The year of 2005 | The year of 2004 |
| CSSC | 600,000,000.00 | 600,000,000.00 | 600,000.00 | 1,225,000.00 |
| CSTC | — | — | — | — |
| CSSC Guangzhou Holding Co. | 18,070,900.00 | — | 500,000.00 | — |
| Sub-total | <u>618,070,900.00</u> | <u>600,000,000.00</u> | <u>1,100,000.00</u> | <u>1,225,000.00</u> |

(6) Sales agent by CSSC

| Company | Agent Amount | |
|--|----------------------|---------------------|
| | The year of 2005 | The year of 2004 |
| China Shipping Industrial Trading Company | 20,343,692.47 | 7,204,798.74 |
| China Shipping International Trading Company | <u>8,764,547.99</u> | <u>1,552,219.77</u> |
| Sub-total | <u>29,108,240.46</u> | <u>8,757,018.51</u> |

(7) Purchase agent by CSSC

| Agent | Total | | Imported Material | | Marine Equipment | | Production Equipment | |
|---|---------------------|---------------------|-------------------|-----------------|------------------|------------------|----------------------|---------------------|
| | This period | Last period | This period | Last period | This period | Last period | This period | Last period |
| China United Shipbuilding Co.,Ltd | 3,308,313.59 | 4,270,468.70 | — | — | — | — | 3,308,313.59 | 4,270,468.70 |
| China Shipping Industrial Trading Company | <u>75,121.61</u> | <u>88,836.60</u> | — | <u>6,200.81</u> | <u>31,475.02</u> | <u>82,635.79</u> | <u>43,646.59</u> | <u>—</u> |
| Sub-total | <u>3,383,435.20</u> | <u>4,359,305.30</u> | <u>—</u> | <u>6,200.81</u> | <u>31,475.02</u> | <u>82,635.79</u> | <u>3,351,960.18</u> | <u>4,270,468.70</u> |

NOTES TO THE FINANCIAL STATEMENTS

(8) Account receivable and payable of connected parties (unit: RMB)

A. Other receivable

| Company | December 31, 2005 | December 31, 2004 |
|----------------------------|-------------------|-------------------|
| CSSC | — | — |
| CSSC Guangzhou Holding Co. | — | 47,971.75 |
| | <hr/> | <hr/> |
| Total | — | 47,971.75 |
| | <hr/> <hr/> | <hr/> <hr/> |

B. Account receivable

| Name | December 31, 2005 | December 31, 2004 |
|---|-------------------|-------------------|
| Guangzhou Huangpu Shipyard | 152,004.27 | 106,747.20 |
| Guangzhou Shipyard | 109,480.00 | — |
| Guangzhou Wenchong Shipyard | 5,202.15 | 1,276,498.04 |
| CSSC | 30,000.00 | — |
| Huanan Marine Mechanic and Electric Department | — | 390,534.30 |
| | <hr/> | <hr/> |
| Total | 296,686.42 | 1,773,779.54 |
| | <hr/> <hr/> | <hr/> <hr/> |

C. Advanced Payment

| Company | December 31, 2005 | December 31, 2004 |
|---|-------------------|-------------------|
| Guangzhou Shipyard Guangda Company | — | 4,596,057.79 |
| Guijiang Shipyard | 273,200.00 | 628,000.00 |
| Guangzhou Shipyard | — | 57,159.45 |
| Huanan Marine Mechanic and Electric Department | 6,467,927.85 | 621,000.00 |
| Hudong Heavy Engineering Company Limited | — | 6,000,000.00 |
| Zhenjiang Marine Diesel Factory | 16,800,000.00 | 6,680,000.00 |
| Guangzhou wenchong shipyard | 90,000.00 | — |
| CSSC International Trade Co.,Ltd | 3,318.83 | 81,535.77 |
| | <hr/> | <hr/> |
| Total | 23,634,446.68 | 18,663,753.01 |
| | <hr/> <hr/> | <hr/> <hr/> |

NOTES TO THE FINANCIAL STATEMENTS

D. Account payable

| Company | December 31, 2005 | December 31, 2004 |
|--|----------------------|----------------------|
| 611 Institute Shanghai Sanjin Technology Co., Ltd. | 268,195.00 | 668,195.00 |
| CSSC No. 708 Institute | – | 267,000.00 |
| Anqing Marine Electric Factory | – | 145,100.00 |
| Guangzhou Shipyard Gaungda Company | – | 4,514,884.53 |
| Guangzhou Shipyard Forging Company | 236,699.88 | 175,674.00 |
| Guangxi Guijiang shipyard | 64,000.00 | – |
| Guangzhou Wenchong Shipyard | 629,534.95 | 736.00 |
| Guangzhou Shipyard | 1,014,943.30 | 7,096,667.35 |
| Huanan Marine Mechanic and Electric Department | 340,000.00 | 1,532,151.30 |
| Haiying limited company | 30,000.00 | – |
| Hudong Corporation Electric Division | 113,750.00 | 138,500.00 |
| Hudong Heavy Engineering Company Limited | – | 550,000.00 |
| Huahai Marine Commodity Logistic Company | – | 289,834.29 |
| Jiangxi Chaoyang Machine Factory | 21,736.66 | 21,427.39 |
| Jiangxi marine Valve Factory | 10,500.00 | 215,000.00 |
| Jiujiang Marine Mechanical Factory | 57,320.00 | 1,328,200.30 |
| Jiujiang Instrument Factory | 25,250.00 | 26,000.00 |
| Nanjing Lvzhou Machinery Factory | – | 2,306,450.43 |
| CSSC Luzhou Environment Protection Equipment Co.,Ltd | 66,000.00 | 300,080.00 |
| Shanghai Shipyard | 142,794.70 | 142,794.70 |
| Shanghai Navigation Instrument Factory | 16,315.00 | 359,800.00 |
| Zhenjiang Marine Auxiliary Machine Factory | 498,000.00 | 2,021,728.34 |
| Zhenjiang Marine Propeller Factory | 40,030.00 | 50,430.00 |
| Zhenjiang Marine Diesel Factory | 7,117,975.00 | 782,131.81 |
| Zhengmao Group Company Limited | – | 433,787.00 |
| China State Shipbuilding Corporation | – | – |
| China Shipping Trading Corporation | 245,788.32 | 257,046.82 |
| CSSC System Engineering Department | – | 1,426,154.00 |
| Total | <u>10,938,832.81</u> | <u>25,049,773.26</u> |

NOTES TO THE FINANCIAL STATEMENTS

E. Other Account payable

| Name | December 31, 2005 | December 31, 2004 |
|------------------------------------|-------------------|-------------------|
| Guangzhou Shipyard | – | 30,536.00 |
| Guangzhou Shipyard Guangda Company | 17,072.00 | 17,072.00 |
| CSSC | – | 27,000.00 |
| | <hr/> | <hr/> |
| Total | 17,072.00 | 74,608.00 |
| | <hr/> | <hr/> |

F. Advances form Customers

| Name | December 31, 2005 | December 31, 2004 |
|----------------------------|-------------------|-------------------|
| Guangzhou Shipyard | – | 3,500.00 |
| Guangzhou Huangpu Shipyard | – | 24,500.00 |
| Xijiang Shipyard | 180,000.00 | 180,000.00 |
| | <hr/> | <hr/> |
| Total | 180,000.00 | 208,000.00 |
| | <hr/> | <hr/> |

(VII) CONDITION OF CAPITAL INFLOW AND OUTFLOW BETWEEN THE COMPANY AND ITS SUBSIDIARIES

The capital flowing between the Company and its subsidiaries is mainly by selling and purchasing goods. It's not exist other issues stated in "the Notice of Standard the Finance Dealing with Connected Parties and the External Guarantees of List Companies", Zhen Jian Zi [2003] No.56.

(VIII) CONTINGENCIES

Since April 2000, the Company raised the litigation against Changda Company for the overdue payment of the project of manufacturing, painting the steel box girder of Humen Bridge, and manufacturing the traveling crane. The Company received the judgment on August 22, 2003 by the Final Judgment forwarded by the Supreme Court of Guangdong Province, which demanded Changda Company to pay to the Company the liquidated damage and the interest in amount of RMB13.2320 million, which was received on September 24, 2003 and calculated into the current Profit & Loss of the Company. On July 22, 2004, the Company received the Civil Administration Procuratorial Register Decision from Procuratorate of Guangdong Province, which declared Changda Company did not give in to the judgment of the Supreme Court of Guangdong Province, and it has appealed to Procuratorate of Guangdong Province. In January 2006, the Company receives a note of hearing, which declared that Changda Company did not give in the judgment and applied for retrial. The Company will pay close attention to the matter, and will publish the information according with correlated rules of publishing.

NOTES TO THE FINANCIAL STATEMENTS

(IX) COMMITMENTS

1. The 11th meeting of the fifth term of Board of Directors held on March 23, 2006 and approved the resolution that in order to improve the competence, the Company invests in Zhenjian CSSC Equipment Co., Ltd, whose principal business is generator manufacturing, on the basis of over 10% yield, with its own capital amounting less than USD 2 million, and on behalf of its subsidiary in 2006 to enter necessary industrial.
2. The Company approved the proposal of developing housing monetary allowances policy for retired employees in the seven meeting of the fifth term of the Board of Directors. The policy is going to be started in 2006, and the total amount of the allowances is less than RMB24 million which would be paid within two years.

(X) EVENTS POST PERIOD OF BALANCE SHEET

1. A Framework Agreement was entered into between the Company and GZITIC on February 20, 2006, pursuant to which GZITIC will procure transfer of Compensatory Assets to the Company in settlement of debts owing to the Company in the principal amount of RMB 169,923,134 (approximately HKD163,387,629) and interest otherwise accrued thereon. The compensatory assets included: property in Hengyang City of Hunan Province, Shenzhen City, Guangzhou City and Heshan City of Guangdong Province, 108 golf membership cards and creditor's rights of RMB10.64 million in Hong Kong Guanghong Intl' Co., Ltd (the Company and Hong Kong Guanghong Intl' Co., Ltd. had come to an agreement for Guanghong Co. to settle the debts in the amount of RMB10.64 million with cash, automobile and equity interest in other companies, GZITIC has agreed to assist in the implementation and completion of such assignment of creditor's rights). As at the date that this report disclosed, the Company has obtained part of the certifications of the real estates and cash. The debt restructuring will be finished once all the Compensatory Assets of GZITIC have been transferred to the Company, and all the trust deposit in GZITIC will be cancelled.
2. The fourth meeting of the fifth term of the Board of Directors held on October 10, 2005 passed the resolution of transferring 26% of the interest in Guangzhou Hongfan Information Technique Co., Ltd (70% controlled by the Company) to Information and technology Company Limited of CSSC (a connected party of the Company). For the development of shipbuilding informatization, approving Information and technology Company Limited of CSSC to be the shareholder will improve the reputation of Hongfan Information Technique Co., Ltd and strengthen the cooperation between two parties in marine material management, shipbuilding management, collectivization finance management and information security technology. The transferring agreement was signed on January 6, 2006. The first transferring payment was received on January 24, 2006 and will be noticed in Profit and Loss Accounts of 2006.

NOTES TO THE FINANCIAL STATEMENTS

3. The fifth meeting of the fifth term of the Board of Directors held on October 26, 2005 approved the proposal of selling the property of the fourth and the fifth floor of the office building located in No. 126 in Gexin Lu of Haizhu District in Guangzhou City to Guangzhou Marine Engineering Corporation (a connected party with the Company) according to the evaluating price by professional evaluators. The sale above can reduce the daily management cost, and is advantageous to improving the occupancy efficiency and income. The transfer agreement was signed on January 13, 2006. The first transferring payment was received on March 1, 2006 and will be noticed in Profit and Loss Accounts of 2006.

(XI) OTHER ISSUES

1. The meeting of Board of Directors was held on March 23, 2006 and passed the decision of the profit no-distribution and non-conversation for the year of 2005.
2. The Company has received the share reform motion letter and authority letter from CSSC, the non-listed shareholder of the Company on February 28, 2005, which indicated the beginning of the share reform of the Company. The sponsoring institution and the lawyer of the share reform of the Company are Shenyin & Wanguo Securities Co., Ltd. and Beijing Junhe Law offices respectively, who were appointed and will be paid by CSSC.