

(1) Review of operations

1. Overview of operations

Since Year 2005 is the last year of the PRC's 10th 5-Year-Plan, in which the PRC economy continues to grow rapidly, the market demand for manufacturing machines remains strong, offering business opportunities for the Group. Under the corporate culture of 'Open, Competitive and Creative', the Company continues to enlarge business, and improve product quality and operation structure. In addition, the Company has developed 3 approaches to improve the efficiency of modular design, craftsmanship and quantified scientific technology. Through internal corporate management and development of new markets, the Company's potential is enhanced and activated. Thus, the Company's competitiveness in the market is increasing, distribution scale is widening, products quality is continuously improving and economic advantage is continuously growing. These all contribute to the Company's continuing development every year.

During the reporting period, the Company has attained a turnover of RMB672,643,000 and a net profit for the year of RMB18,321,000, representing an increase of 203,207,000 and 35,402,000 respectively, as compared with last year's turnover of RMB469,436,000 and net loss of RMB17,081,000. The operating activities for the boring and turbo machines had attained a turnover of RMB438,835,000 and a net profit of RMB32,774,000, representing an increase of 54.46% and 86.53% respectively as compared with last year. Non-boring and non-turbo machines had attained a turnover of RMB243,054,000 and a net loss of 4,369,000, comparatively to last year's turnover of RMB190,663,000 and net profit of RMB6,074,000.

2. Main products comprising 10% or more of the Turnover of Gross Profit

Business or products	Turnover	Cost	Unit: RMB'000
			Gross Profit (%)
Turbo machines	438,835	324,367	26.08%
Sales, installation and technical services of highly efficient compressor	209,774	157,525	24.91%

During 2005, the Company had attained a turnover of RMB672,643,000, representing an increase of RMB203,207,000 as compared with 2004. The operating activities for the boring and turbo machines had attained an increase in income of RMB154,722,000, representing a growth of 54.46%. On the other hand, Ser had attained an increase in income of RMB72,322,000, representing a growth of 52.62%. Based on sales structure, in 2005, the sales of the boring machines is 65.24% of the total sales profit, representing a growth of 4.72%. For operating activities of Ser, the sale of turbo machines is 31.19% of the total sales profit, representing a growth of 1.91%. Their total sales figure is 96.43% of the total sales profit.

3. Reasons of the Change in Major Operating Market and the Change in Structure of Major Operating Costs

In 2005, the Company's consolidated gross profit is 26.06%, representing 1.66% decrease from the gross profit of last year, which was 27.72%. The decrease of the consolidated gross profit is caused by the decrease of 1.59% in the gross profit from the boring and turbo machines. Analysis as the following:

- (1) Due to decreasing purchase prices of raw materials in 2005, the proportion of raw materials in the total operating costs has decreased by 3.16%.
- (2) As the increasing scale of staff salary is less than the increase scales of values of outputs of production and turnover, the proportion of direct salary in the total operating cost has decreased by 2.06%.
- (3) Due to the limitation of the Company's production capacity, part of the machines has been overloaded in production. To reach the production target, the Company enlarged its business of additional accessory processing, leading to the proportional increase of 6.88% of outsource contracting fee in the total operating cost.

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4. Analysis of turnover and market share of main business and products:

Unit: RMB'000

Business or products	2005 Turnover	2004 Turnover	increase/decrease %
Business			
General facilities production	130,900	126,841	3.20
Specified facilities production	140,116	80,219	74.67
Transportation facilities production	31,296	13,579	130.47
Other production	93,891	41,150	128.17
Products			
Horizontal boring and milling machines	194,521	159,896	21.65
Floor-type boring and milling machines	133,330	46,161	188.84
Table-type boring and milling machines	33,882	22,223	52.46
Horizontal machine centres	19,809	23,639	(16.20)
Jig boring machines	13,548	8,362	62.02
Others	1,113	1,508	(26.19)
Total	396,203	261,789	51.34

5. Major Suppliers and Customers

Unit: RMB'000

Suppliers	Purchase Amount
Siemens	23,209.18
Beijing Haiyang Fagor Automation Limited	8,347.31
Kunming Shuangshun Commercial Limited	5,363.84
昆明大板橋鍛造有限公司	5,350.39
Heidenhain (Tianjin) Optics and Electronics Co. Ltd.	4,705.46
Total	46,976.18
Purchase for the year	141,603.99

Note: The purchases from the top 5 suppliers represent 33.17% of the total purchase for the year.

The sale of the top 5 customers is RMB73,248,000, representing 10.89% of the total sales for the year.

6. Analysis of the changes in Assets structures and proportions

Unit: RMB'000

Items	As at 31st December, 2005	As at 1st January, 2005	Amount increase/ (decrease)	% increase/ (decrease)
Bank balances and cash	171,876	196,667	(24,791)	(12.61)%
Short-term investments	12,774	13,454	(680)	(5.05)%
Accounts receivable	86,505	77,678	8,827	11.36%
Other receivables	23,806	11,320	12,486	110.30%
Prepayments	26,107	61,484	(35,377)	(57.54)%
Inventories	274,503	323,471	(48,968)	(15.14)%
Fixed assets				
(Including construction-in-progress)	377,361	348,451	28,910	8.30%
Long-term equity investments	32,209	9,788	22,421	229.07%
Intangible assets	54,911	65,345	(10,434)	(15.97)%
Long-term, short-term bank borrowings	100,000	137,091	(37,091)	(27.06)%
Accounts payables	100,037	62,641	37,396	59.70%
Advances from customers	196,375	294,382	(98,007)	(33.29)%
Specific project payable	6,783	2,648	4,135	156.16%
Deferred gain	—	9,714	(9,714)	(100)%
Principal operating income	672,643	469,436	203,207	43.29%
Administrative expenses	86,335	66,762	19,573	29.32%
Non-operating expenses	13,783	1,232	12,551	1018.75%

- A. Bank balances and cash has decreased by RMB24,791,000 from last year. Reason: bank borrowing of RMB37,091,000 is repaid during the year;
- B. Short-term investments has decreased by RMB680,000 from the last year. Reason: the drop in market prices of stocks held by China Fortune Securities and the impairment loss was recognised;
- C. Compared to last year, inventories has decreased by RMB48,968,000, prepayments has decreased by RMB35,377,000, accounts payable has increased by RMB37,396,000, accounts receivable has increased by RMB8,827,000 and advances from customers has decreased by RMB98,007,000. Reason: Kunji and Ser have raised the amount of products completion and handover, leading to the increase in the Company's turnover;
- D. Other receivables has increased by RMB12,486,000 from last year. Reason: those increased in Ser;
- E. Long-term equity investments has increased by RMB22,421,000. Reason: the jointly investment in TOS Kunming Machine Tool Company Limited between Kunji and Czech TOS in 2005;
- F. Fixed assets (including construction-in-progress) have increased by RMB28,910,000. Reason: additions increased in the Kunji and Ser;
- G. Intangible assets have decreased by RMB10,434,000. Reason: the impairment loss of RMB5,943,000 are recognised and the amortization was provided during the year;
- H. Administration expenses has increased by RMB19,573,000. Reason: the provision for bad debts and the provision for of inventories in 2005 are RMB6,170,000 more than those in last year, the salary and labour insurance of Kunji has increased by RMB3,240,000, the administration expense of Ser has increased by RMB2,920,000, the administration expense of Winko has increased by RMB2,750,000 (the loss in disposal of inventories);
- I. Non-operating expenses has increased by RMB12,551,000. Reason: the provision on impairment loss of intangible assets is RMB5,943,000 in 2005 and the loss on disposal of fixed assets in Winko is RMB5,386,000;

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- J. Specific project payable has increased by RMB4,135,000. Reasons: the compressor monitoring system software and other specific project expenses in Ser are RMB4,107,000;
- K. The Company reduces the deferred gain and profit for the year to RMB8,849,000 and RMB2,135,000 respectively. Reason(s): According to Document No. 1 in February 2002 of the Department of Finance of Yunnan Province, the Company have to pay Land Appreciation Tax (LAT) of RMB10,984,000 (figure subjected to changes and temporarily waived) as a result of capital restructuring of buildings with the Provincial Government; In March 2005, Tax Policy Department, Ministry of Finance issued the Document No. 6 in 2005, referring that the building transfer would result in Land Appreciation Tax payable.

7. Analysis of major financial data and changes

Items	At the end of the year	At the beginning of the year	Amount increase/ (decrease)	Unit: RMB'000 %
				increase/ (decrease)
Total assets	1,079,184	1,125,840	(46,656)	(4.14)%
Principal operating profit	175,290	130,138	45,152	34.70%
Net profit	18,321	(17,081)	35,402	—
Decrease in cash and cash equivalent	(28,376)	21,118	(49,494)	—
Share equity	531,994	504,771	27,223	5.39%

- (1) Decrease in total assets is due to the loss in Winko, resulting in reduced scale of assets;
- (2) Increase in principal operating profit is due to the increase in sales for the year;
- (3) High increase in net profit is due to the effect of non-operating result from RMB37,480,000 of impairment loss on available-for-sale investment provided in 2004;
- (4) Decrease in cash and cash equivalent is due to the decrease in bank borrowings;
- (5) The increase in share equity is due to the increase in net profit for the year to RMB18,321,000 and capital reserves has increased by RMB8,902,000 (the increase in valuation of fixed assets in Kunji's investment in jointly controlled entity – TOS Kunming Machine Tool Company Limited).

8. Analysis of cash flow structure and its major changes, and reasons of net profit fluctuation:

Cash flow generated from operating activities was RMB61,718,000, representing a decrease of RMB45,479,000 from last year. This is because there has been an increase in cash paid to staff of RMB27,963,000 and increase in taxation paid of RMB30,593,000. Cash flow used in investment activities was RMB64,246,000, representing an increase of RMB53,102,000 from last year there were available-for-sale investments of RMB50,000,000 in 2004 but not in 2005. Cash flow used in capital raising activities was RMB25,847,000, representing a decrease of RMB57,118,000 since there was repayment of bank loans. The net profits for the year has increased while the increase in cash and cash equivalents have been reduced because while there was an increase in revenue, accounts receivable also increased, and bank loans are repaid.

9. Discussion and analysis of important issues which are closely related to the company's operation, including the company's usage of equipment, receipt of purchase orders, sales of products or stock turnover period and movements of major technical staff

The amount of contracts newly signed during 2005 is RMB563,216,000, of which 60.21% were digitalized machines. Inventories included small number of general floor-typed boring machines and there was no movement of major technical staff.

10. Review of operations for subsidiaries and controlling companies

(1) Operations of Subsidiaries

Unit: RMB'000

Name of company	Nature of business	Major product or service	Registered share capital	Total assets	Net profit
Xian Ser Turbo Machinery Company Limited ("Xian Ser")	Manufacturing	Turbo machine	50,000	277,455	21,987
Shanxi Hentong Intelligent Machine Company Limited	Manufacturing	Laser prototyping machine	27,960	28,066	(1,862)
Xian Jiaotong University Siyuan Intelligent Electric Apparatus Company Limited ("Intelligent")	Manufacturing	Intelligent electrical appliances	35,000	45,914	(7,046)
Winko Machines Company Limited ("Winko")	Manufacturing	Computerized embroidery machine	20,230	26,434	(17,447)
TOS Kunming Machine Tool Company Limited	Manufacturing	Development, design, production and sales of self-produced machines and accessories	Euro 5,000,000	52,304	(1,841)

(2) Review of subsidiaries or controlling companies (profit from investments with 10% or more of total net profit):

Unit: RMB'000

Name of company	Turnover	Profit	Net Profit
Xian Ser	209,774	50,734	21,987
Winko	10,112	1,887	(17,447)
Intelligent	10,372	5,024	(7,046)

(3) Analysis of performance of subsidiaries or controlling companies

In 2005, there is a huge loss of RMB17,447,000 in Winko (the main reasons are the end of production in computerized embroidery machines and the termination of Suzhou branch), including loss on disposal of fixed assets of RMB1,157,000, loss on disposal of inventories of RMB3,171,000, impairment loss on assets of RMB10,201,000. There is also a loss of RMB7,046,000 in Intelligent, reasons: the contract for construction of building has expired in 2005, so the Company has to be responsible for the operating fee of RMB1,229,000, and there is an impairment loss of intangible assets of RMB3,390,000.

(2) Expectations on future development

1. Analysis of industry development, trend and market competitiveness and effects on the Company

The PRC's 11th 5-year-plan started in 2006, in which the PRC Government has proposed to speed up the development of machine parts production and to offer more assistance to the turbo machines industry. The development of digital machines is considered as an important technology development of the State, with beneficial policy on capital and taxation. Related industries are also under major development, which has led to the growth of the turbo machines industry. The market competition is intense and the demand for large and precise digital machines is continuously increasing; for normal machines, the growth of demand is stable.

Under this situation, the Company values its human resources and further strengthens internal management. The Company also aims at working hard on opening markets, speeding up developments of new products, improving technology, enhancing skills of production management, enlarging external co-operations, expanding scopes of sales, improving economical advantages, and ensuring sustainable business.

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(3) Investing Activities

Information of the Invested Companies

Name of Subsidiaries and Joint Venture	Place of Registration	Scope of Business	Registered Capital (RMB)'000	Investment Proportion	Economic Nature	Date of Investment	Relationship with the Company
Xian Ser Turbo Machinery Company Limited	Xian City	Design, development and sales of turbo-machinery.	50,000	45.00%	Limited liability	2001.12	Subsidiary
Shanxi Hengtong Intelligent Company Limited	Xian City	Development and sales of machine manufacturing moulds, machinery, equipment, electronic products, software and hardware.	27,960	65.34%	Limited liability	2001.12	Subsidiary
Xan Jiaotong University Siyuan Intelligent Electric Apparatus Company Limited	Xian City	Development, manufacture and sale of electronic products, electronic machine and products of electronic power; provide technology services.	35,000	78.03%	Limited liability	2002.12	Subsidiary
Winko Machines Company Limited	Kunming City	Develop, apply and integrate hardware and software; retail, wholesale, purchase on behalf of others and consign electronic products, machinery and electronic machine.	20,230	95.50%	Limited liability	2002.11	Subsidiary
TOS Kunming Machine Tool Company Limited	Kunming City	Development, design, manufacture and sales of turbo machines and high-tech products; and repairs of machines.	EUR 5,000,000	50%	Sino-foreign operation	2005.04	Joint Venture
Changsha Ser Turbo Machinery Equipment Company Limited	Changsha City	Design, development and sales of turbo machinery.	10,000	95.00%	Limited liability	2004.01	Subsidiary of Xian Ser
Hangzhou Ser Gas Engineering Company Limited	Hangzhou City	Design, development and sales of turbo machinery; technology development; retail and wholesales of construction materials; and import and export business	1,200	51.00%	Limited liability	2004.04	Subsidiary of Xian Ser

1. Use of Proceeds from Raised Funds

There were no new proceeds from raised funds during the reporting period and there were no listing proceeds from previous year being utilized during the reporting period.

2. Principal Investments financed by Non-raised funds

Investment items/ Investee	Registered Capital	Investment Proportion	Initial Investment	<i>Unit: RMB'000</i>
				Mode of Investment
TOS Kunming Machine Tool Company Limited	EUR5,000,000	50%	24,740	Cash, Plant and Equipment

(4) Day to Day Operating of the Board of Directors

1. The Board of Directors' Meeting and Resolution

- 1) On 23rd March, 2005, the twenty first resolution of the Forth Board of Directors' Meeting in written was held.
- 2) On 27th April, 2005, the twenty second resolution of the Fourth Board of Directors' Meeting was held and resolution was announced in "China Securities Daily", "Shanghai Securities Daily", "Wen Wei Po" and "China Daily" on 28th April, 2005.
- 3) On 20th May, 2005, the twenty third resolution of the Fourth Board of Directors' Meeting was held and resolution was announced in "China Securities Daily", "Shanghai Securities Daily", "Wen Wei Po" and "China Daily" on 25th May, 2005.
- 4) On 16th June, 2005, the twenty forth resolution of the Fourth Board of Directors' Meeting was held and resolution was announced in "China Securities Daily", "Shanghai Securities Daily", "Wen Wei Po" and "China Daily" on 17th June, 2005.
- 5) On 21st June, 2005, the twenty fifth resolution of the Forth Board of Directors' Meeting in written was held.
- 6) On 17th August, 2005, the twenty sixth resolution of the Fourth Board of Directors' Meeting was held and resolution was announced in "China Securities Daily", "Shanghai Securities Daily", "Wen Wei Po" and "China Daily" on 17th August, 2005.
- 7) On 18th August, 2005, the twenty seventh resolution of the Forth Board of Directors' Meeting in written was held.
- 8) On 13th September, 2005, the twenty eighth resolution of the Fourth Board of Directors' Meeting was held and resolution was announced in "China Securities Daily", "Shanghai Securities Daily", "Wen Wei Po" and "China Daily" on 15th September, 2005.
- 9) On 20th September, 2005, the twenty ninth resolution of the Forth Board of Directors' Meeting in written was held.
- 10) On 31st October, 2005, the first resolution of the Fifth Board of Directors' Meeting was held and resolution was announced in "China Securities Daily", "Shanghai Securities Daily", "Wen Wei Po" and "China Daily" on 31st October, 2005.
- 11) On 3rd November, 2005, the second resolution of the Fifth Board of Directors' Meeting in written was held.

Eleven Directors' Meeting, including seven written resolutions had been held during the year. Except for resolutions in the twenty first and twenty seven of the Fourth Board of Directors' Meeting were not passed, all others were passed through.

2. Implement of Resolution of General Shareholders's Meeting

During the reporting period, the Board of Directors had acted their statutory power and duties carefully as provided in the Shareholders' meeting.

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(5) The Board of Directors' Proposal on the Profit Appropriation or Transfer of Capital Reserve Fund

In accordance to the Company's Articles of Association, the Group has attained a net profit for the year. Profit for the year will be used to set off losses brought forward from previous years. Thus no appropriation and no transfer were made to the statutory surplus reserve and the statutory public welfare fund.

(6) Statement Regarding the Use of Funds by the Company's Controlling Shareholder and Other Related Parties

Xi Hui Qi Zi (2006) No.016 Concerning the Usage of Capital by the Controlling Shareholders and other Related Parties of Jiaoda Kunji High-Tech Company Limited

To all shareholders of the Company:

We have accepted the appointment and audited the financial statements of Jiaoda Kunji High-Tech Company Limited ("the Company") for the year ended 31st December, 2005 and have issued the Xi Hui Shen Zi (2006) 0400 (Audited Report). We have performed audit procedures in the course of our audit of the financial statement for the year 2005 on the use of funds by the Company's Controlling shareholder and other related parties. According to the requirements under "Notice concerning the regulation on the flow of funds between listed companies and other related parties and the provision of guarantees by listed companies to external parties" (Zheng Jian Fa [2003] No. 56).

Movements in Non operating capital and other related capital for the year

Unit: '000

Non-operational use of capital	Names of shareholders/ controlling parties	Relationship with the company	Items	Balance at the beginning of the year	Advances during the year (Exclusive of interest)	Interest	Repayments during the year	Balance as at year end	Purpose	Nature
Largest shareholder and its respective subsidiaries	Xian Jiaotong University Industrial (Group) Incorporation	Controlling shareholder	Other receivables	-	30,000.00	101.10	30,101.10	-	Temporary payment	Non operational
	Xian Jiaoda Precision Engineering Company Limited	Fellow subsidiary of controlling shareholder	Other receivables	-	300.00	-	-	300.00	Temporary payment	Non operational
	Pharmacy Group of Xian Jiaotong University	Fellow subsidiary of controlling shareholder	Other receivables	-	10,000.00	-	-	10,000.00	Temporary payment	Non operational
	Pharmacy Group of Xian Jiaotong University	Fellow subsidiary of controlling shareholder	Other payables	-	-	-	500.00	(500.00)	Temporary receipt	Non operational
Sub Total	-	-	-	-	40,300.00	101.10	30,601.10	9,800.00	-	-
Former largest shareholder	-	-	-	-	-	-	-	-	-	Non operational
-	-	-	-	-	-	-	-	-	-	Non operational
Sub Total	-	-	-	-	-	-	-	-	-	-
Total	-	-	-	-	40,300.00	101.10	30,601.10	9,800.00	-	-

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Unit: '000

Other related capital transactions	Names of shareholders/controlling parties	Relationship with the company	Items	Balance at the beginning of the year	Advances during the year (Exclusive of interest)	Interest	Repayments during the year	Balance as at year end	Purpose	Nature
Largest shareholder and its respective subsidiaries	Jiaoda HongFan High-Tech Company Limited	Fellow subsidiary of controlling shareholder	Prepayments	248.70	1,234.60	—	1,364.60	118.70	Purchase of goods	Operational
	Jiaoda HongFan High-Tech Company Limited	Fellow subsidiary of controlling shareholder	Payables	—	—	—	383.90	(383.90)	Purchase of goods	Operational
	Xian Jiaoda Precision Engineering Company Limited	Fellow subsidiary of controlling shareholder	Other receivables	45.20	—	—	—	45.20	Tender guarantee	Operational
	Xian Jiaotong University Industrial (Group) Incorporation (Other group companies)	Actual controlling person	Receivables	31.50	1,296.50	—	1,005.20	322.80	Sales of goods	Operational
	Xian Jiaotong University Industrial (Group) Incorporation (Other group companies)	Actual controlling person	Other receivables	300.00	—	—	—	300.00	Construction Deposits	Operational
	Xian Jiaotong University	Actual controlling person	Prepayments	100.00	—	—	—	100.00	Purchases	Operational
Fellow subsidiaries and other related companies	Winko Machines Company Limited	Subsidiary	Other receivables	—	16,091.00	—	—	16,091.00	Temporary payment	Non operational
	TOS Kunming Machine Tool Company Limited ("TOS")	Subsidiary	Other receivables	—	2,000.00	—	2,000.00	—	Temporary payment	Non operational
Related persons and legal persons	—	—	—	—	—	—	—	—	—	Non operational
	—	—	—	—	—	—	—	—	—	Non operational
Other related persons and their subsidiaries	—	—	—	—	—	—	—	—	—	Non operational
	—	—	—	—	—	—	—	—	—	Non operational
Total	—	—	—	725.40	20,622.10	—	4,753.70	16,593.90	—	—

The Company's usage of capital in the period are as follows:

- The non-operational usage of the Company's capital by its largest shareholder and its respective subsidiaries at the beginning of the year amounted to RMB320,200. The accumulated non-operational usage of capital in the year amounted to RMB40,300,000 and interest amounted to RMB101,100, with RMB30,600,110 being repaid. As at 31st December, 2005, the largest shareholder and its respective subsidiaries' non-operational usage of capital amounted to RMB10,120,200.

There is no occurrence of usage of non-operational capital by the Company's former largest shareholder and its respective and its respective subsidiaries in this year.

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2. Other Connected Transactions:

- (1) The operational usage of the Company's capital by its largest shareholder and its respective subsidiaries at the beginning of the year amounted to RMB280,020. The accumulated operational usage of capital in the year amounted to RMB2,531,100, with repayment and provision of goods of RMB2,753,600. As at 31st December, 2005, the largest shareholder and its respective subsidiaries' operational usage of capital amounted to RMB57,700.
- (2) The non-operational usage of the Company's capital by its subsidiaries amounted to RMB930,000. The accumulated non-operational usage of the Company's capital amounted to RMB18,091,000, with repayment of RMB2,930,000. As at 31st December, 2005, the company's subsidiaries' non-operational usages of the Company's capital amounted to RMB16,091,000.

3. There is no occurrence of usage of capital by related natural person and its controlling legal person, other related person and its connected company in this year.

We find the company did not provide funds to the other parties save as mentioned above. We were not aware of any circumstances stated in "Notice concerning the regulation on the flow of funds between listed companies and other related parties and the provision of guarantees by listed companies to external parties" (Zheng Jian Fa [2003] No. 56) shown below:

- (1) The Company's controlling shareholder and other related parties require the company to pay for their salaries, staff welfare, insurance expenses, advertising expenses and share the production cost and other expenses;
- (2) Guarantee for the loan borrowed from financial institutions and non-financial institutions;
- (3) Appointment of the Company's controlling shareholder and other related parties to engage in security trading;
- (4) Issuance of bank note for fraudulent business transactions;
- (5) Settlement of loans for the Company's controlling shareholder and other related parties.

Xian Xigema Certified Public Accountants Firm Limited

Chinese Certified Public Accountant: Wang Yong Zhong
Chinese Certified Public Accountant: Fan Min Hua

Xian, the PRC
10th April, 2006