

AUDITORS' REPORT

Xian Xigema Certified Public Accountants Firm Limited

Xi Hui Shen Zi (2006) No.0400
Auditors' report

To all shareholders of Jiaoda Kunji High-Tech Company Limited,

We have audited the Group's and the Company's balance sheet as at 31st December, 2005 and the Group's and the Company's statement of income and cash flow statement for the year then ended. These financial statements are the responsibilities of the Company. Our responsibility is to express an opinion on these financial statements based on our audit.

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

In our opinion, such financial statements are prepared in conformity with the "Accounting Standard for Business Enterprises" and the "Accounting Regulations for Business Enterprises" and, in all material respects, present fairly the financial positions of the Company as at 31st December, 2005 and the results of its operations and cash flow for the year then ended.

Xian Xigema Certified Public Accountants Firm Limited

Xian, the PRC

Chinese Certified Public Accountant

Wang Yong Zhong

Chinese Certified Public Accountant

Fan Min Hua

10th April, 2006

BALANCE SHEET

AS AT 31ST DECEMBER, 2005

Unit: RMB

ASSETS	Note	31st December, 2005		31st December, 2004	
		The Group	The Company	The Group	The Company
CURRENT ASSETS:					
Bank balances and cash	5.1	171,876,071.40	116,260,474.57	196,667,287.24	121,861,338.59
Short-term investments	5.2	12,773,633.85	12,773,633.85	13,454,045.52	13,454,045.52
Bills receivable	5.3	19,057,802.00	14,968,802.00	17,947,434.06	14,092,474.06
Dividends receivable		—	2,000,000.00	—	4,163,885.27
Interest receivable		—	—	—	—
Accounts receivable	5.4	86,505,238.20	39,739,434.81	77,677,859.61	31,942,562.76
Other receivable	5.5	23,806,326.81	26,077,578.74	11,319,504.70	6,363,471.58
Prepayments	5.6	26,107,189.35	5,394,947.04	61,483,659.31	2,702,984.45
Subsidies receivable		—	—	—	—
Inventories	5.7	274,502,685.89	175,648,964.45	323,471,136.42	209,794,867.01
Prepaid expenses	5.8	24,301.00	—	124,123.42	—
Net loss on deferred current assets		—	—	—	—
Long-term debt investment due within one year		—	—	—	—
TOTAL CURRENT ASSETS		614,653,248.50	392,863,835.46	702,145,050.28	404,375,629.24
LONG-TERM INVESTMENTS:					
Long-term equity investments	5.9	32,208,719.62	106,264,789.33	9,788,087.27	96,412,837.03
Comprising: consolidated differences in value	5.9	8,389,904.87	8,389,904.87	9,788,087.27	9,788,087.27
Comprising: difference in equity investments	5.9	8,389,904.87	8,389,904.87	9,788,087.27	9,788,087.27
Long-term debt investment due within one year		—	—	—	—
Total Long-term investments		32,208,719.62	106,264,789.33	9,788,087.27	96,412,837.03
FIXED ASSETS:					
Fixed assets at cost	5.10	525,962,003.16	427,594,988.77	456,791,998.78	374,778,182.93
Less: Accumulated depreciation	5.10	188,265,610.41	164,479,548.96	164,769,276.64	147,919,440.68
FIXED ASSETS , NET BOOK VALUE	5.10	337,696,392.75	263,115,439.81	292,022,722.14	226,858,742.25
Less: Provision for impairment loss	5.10	6,929,723.60	2,700,616.95	1,948,216.95	1,948,216.95
FIXED ASSETS, NET REALISABLE VALUE	5.10	330,766,669.15	260,414,822.86	290,074,505.19	224,910,525.30
Project materials		—	—	—	—
CONSTRUCTION IN PROGRESS, NET REALISABLE VALUE					
Disposal of fixed assets	5.11	46,594,318.14	18,119,165.03	58,376,694.19	34,931,971.28
Loss on deferred fixed assets, net		—	—	—	—
TOTAL FIXED ASSETS		377,360,987.29	278,533,987.89	348,451,199.38	259,842,496.58
INTANGIBLE AND OTHER ASSETS					
Intangible assets	5.12	54,910,745.06	24,773,777.87	65,344,602.05	25,193,228.41
Long-term deferred expenditures	5.13	50,649.20	—	111,441.20	—
Other long-term investments		—	—	—	—
TOTAL INTANGIBLE AND OTHER ASSETS		54,961,394.26	24,773,777.87	65,456,043.25	25,193,228.41
DEFERRED TAXATION:					
Deferred taxation		—	—	—	—
TOTAL ASSETS		1,079,184,349.67	802,436,390.55	1,125,840,380.18	785,824,191.26

Company's Legal Representative: Lei Jinlu
Financial Controller: Yu Yan
Prepared by: Zhao Qiongfen

BALANCE SHEET

AS AT 31ST DECEMBER, 2005

				Unit: RMB	
LIABILITIES AND SHAREHOLDER'S EQUITY	Note	31st December, 2005		31st December, 2004	
		The Group	The Company	The Group	The Company
CURRENT LIABILITIES:					
Short-term loans	5.14	60,000,000.00	40,000,000.00	137,091,000.00	98,000,000.00
Bills payable		—	—	—	—
Accounts payable	5.15	100,037,194.40	40,920,291.77	62,640,557.32	22,005,521.35
Advances from customers	5.16	196,375,494.03	99,153,631.92	294,381,649.15	111,151,535.58
Accrued salary	5.17	3,574,234.94	3,547,327.14	2,401,981.42	2,401,981.42
Accrued welfare		6,421,806.45	3,949,579.01	7,061,979.86	5,094,790.75
Dividends payable		2,101,732.59	—	2,101,732.59	—
Taxes payable	5.18	30,237,113.95	24,632,724.84	14,758,896.08	11,777,336.20
Other payable	5.19	763,673.42	568,537.40	465,951.33	449,815.00
Other accrual	5.2	29,713,634.55	8,391,004.42	25,250,268.44	12,406,383.93
Accrued expenses	5.21	1,562,213.45	1,392,915.45	2,072,716.96	1,779,501.06
Estimated liabilities		—	—	—	—
Long-term loans due within one year	5.22	342,168.90	342,168.90	342,168.90	342,168.90
Other current liabilities		—	—	—	—
TOTAL CURRENT LIABILITIES		431,129,266.68	222,898,180.85	548,568,902.05	265,409,034.19
LONG-TERM LIABILITIES:					
Long-term loans	5.23	40,000,000.00	40,000,000.00	—	—
Long-term payable	5.24	10,269,175.70	3,069,175.70	10,482,384.80	3,282,384.80
Specific project payable	5.25	6,782,628.78	2,675,616.01	2,647,563.01	2,647,563.01
Deferred gain	5.26	—	—	9,714,394.95	9,714,394.95
TOTAL LONG-TERM LIABILITIES		57,051,804.48	45,744,791.71	22,844,342.76	15,644,342.76
DEFERRED TAXATION:					
Deferred taxation		—	—	—	—
TOTAL LIABILITIES		488,181,071.16	268,642,972.56	571,413,244.81	281,053,376.95
MINORITY INTERESTS		59,009,040.36	—	49,656,321.06	—
SHAREHOLDERS' EQUITY:					
Share capital	5.27	245,007,400.00	245,007,400.00	245,007,400.00	245,007,400.00
Less: Returned on investment		—	—	—	—
Share capital, net		245,007,400.00	245,007,400.00	245,007,400.00	245,007,400.00
Capital reserves	5.28	314,193,651.63	314,193,651.63	305,291,280.12	305,291,280.12
Surplus reserves	5.29	16,812,657.84	16,812,657.84	16,812,657.84	16,812,657.84
Including: Statutory public welfare fund	5.29	8,406,328.92	8,406,328.92	8,406,328.92	8,406,328.92
Unappropriated profits	5.3	(44,019,471.32)	(42,220,291.48)	(62,340,523.65)	(62,340,523.65)
TOTAL SHAREHOLDERS' EQUITY		531,994,238.15	533,793,417.99	504,770,814.31	504,770,814.31
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY		1,079,184,349.67	802,436,390.55	1,125,840,380.18	785,824,191.26

Company's Legal Representative: Lei Jinlu

Financial Controller: Yu Yan

Prepared by: Zhao Qiongfeng

STATEMENT OF INCOME

FOR THE YEAR ENDED 31ST DECEMBER, 2005

Unit: RMB

ITEMS	Note	2005		2004	
		The Group	The Company	The Group	The Company
1. Principal operating income	5.31	672,642,923.86	438,834,545.34	469,436,370.36	284,113,480.62
Less: Principal operating cost	5.31	495,526,468.49	324,366,538.29	339,097,776.38	205,494,287.06
Principal operation tax and addition	5.32	1,826,834.56	—	200,105.93	—
2. Principal operating profit		175,289,620.81	114,468,007.05	130,138,488.05	78,619,193.56
Add: Profit from other operations	5.33	(483,467.59)	1,222,352.23	1,245,304.71	1,123,734.41
Less: Selling expenses		32,898,369.10	19,570,041.54	31,360,043.52	16,586,900.17
Administrative expenses		86,334,906.61	50,638,195.60	66,762,377.18	39,670,699.98
Financial expenses	5.34	3,731,668.72	2,325,365.23	6,523,140.76	4,327,378.25
3. Operating profit		51,841,208.79	43,156,756.91	26,738,231.30	19,157,949.57
Add: Investment income	5.35	(2,999,313.31)	(16,531,788.54)	(38,136,044.49)	(35,306,940.51)
Subsidy income	5.36	2,922,171.67	2,000,000.00	2,654,766.16	2,000,000.00
Non-operating income	5.37	372,680.28	293,867.00	266,062.81	125,712.81
Less: Non-operating expenses	5.38	13,783,067.15	2,374,871.21	1,231,959.04	1,151,339.81
4. Profit before income tax		38,353,680.28	26,543,964.16	(9,708,943.26)	(15,174,617.94)
Less: Income tax	5.39	9,751,501.09	6,423,731.99	4,269,092.22	1,906,431.47
Minority interest		10,281,126.86	—	3,103,013.93	—
5. Net profit for the period		18,321,052.33	20,120,232.17	(17,081,049.41)	(17,081,049.41)

Unit: RMB

SUPPLEMENTARY INFORMATION	2005		2004	
	The Group	The Company	The Group	The Company
1. Profit from sale and disposal of investee companies	—	—	—	—
2. Loss arising from natural disasters	—	—	—	—
3. Increase (decrease) in profit due to change in accounting policies	—	—	—	—
4. Increase (decrease) in profit due to change in accounting estimates	—	—	—	—
5. Loss arising from debt restructuring	—	—	—	—
6. Others	—	—	—	—

Company's Legal Representative: Lei Jinlu

Financial Controller: Yu Yan

Prepared by: Zhao Qiongfen

STATEMENT OF APPROPRIATION

FOR THE YEAR ENDED 31ST DECEMBER, 2005

Unit: RMB

ITEMS	Note	2005		2004	
		The Group	The Company	The Group	The Company
1. Net profit for the period	5.3	18,321,052.33	20,120,232.17	(17,081,049.41)	(17,081,049.41)
Add: Accumulated losses at the beginning of the year	5.3	(62,340,523.65)	(62,340,523.65)	(45,259,474.24)	(45,259,474.24)
Other transfer		—	—	—	—
2. Profit for distribution	5.3	(44,019,471.32)	(42,220,291.48)	(62,340,523.65)	(62,340,523.65)
Less: Statutory surplus reserve		—	—	—	—
Statutory public welfare fund		—	—	—	—
Employee welfare and bonus		—	—	—	—
Reserve fund		—	—	—	—
Corporate development fund		—	—	—	—
Return on investment		—	—	—	—
3. Profit available for distribution	5.3	(44,019,471.32)	(42,220,291.48)	(62,340,523.65)	(62,340,523.65)
Less: Preference shares dividend paid		—	—	—	—
Surplus reserve		—	—	—	—
Ordinary share dividend paid		—	—	—	—
Convertible share dividend		—	—	—	—
4. Unappropriate profit	5.3	(44,019,471.32)	(42,220,291.48)	(62,340,523.65)	(62,340,523.65)

Company's Legal Representative: Lei Jinlu
Financial Controller: Yu Yan
Prepared by: Zhao Qiongfeng

CASH FLOW STATEMENT

FOR THE YEAR ENDED 31ST DECEMBER, 2005

ITEMS	Note	Unit: RMB	
		The Group	The Company
1. Cash flows from operating activities:			
Cash received from sales of goods or rendering of services		624,745,800.51	427,306,193.31
Refund of taxes and surcharges received		2,935,072.78	2,000,000.00
Other cash received relating to operating activities		35,457,255.94	34,163,885.27
Sub-total of cash inflows		663,138,129.23	463,470,078.58
Cash paid for goods and services		355,400,257.96	204,762,700.34
Cash paid to and on behalf of employees		84,975,113.56	66,469,693.36
Taxes and surcharges paid		62,957,948.41	43,610,597.84
Other cash paid relating to operating activities	5.39	98,086,967.82	94,577,826.35
Sub-total of cash outflows		601,420,287.75	409,420,817.89
Net cash flows from operating activities		61,717,841.48	54,049,260.69
2. Cash flow from investing activities:			
Receipt of investment proceed		—	—
Dividend income received		2,163,885.27	2,163,885.27
Net cash received from disposal of fixed assets, intangible assets and other long-term assets		41,343.28	12,530.00
Other cash received relating to investing activities	5.40	10,564,260.00	2,853,660.00
Sub-total of cash inflows		12,769,488.55	5,030,075.27
Cash paid to acquire fixed assets, intangible assets and long-term assets		53,231,289.10	32,537,103.42
Cash paid for investment		9,635,733.99	9,635,733.99
Other cash paid relating to investing activities	5.41	14,149,464.78	4,149,464.78
Sub-total of cash outflows		77,016,487.87	46,322,302.19
Net cash flows from investing activities		(64,246,999.32)	(41,292,226.92)
3. Cash flows from financing activities			
Cash from proceeds for use of investment		14,163,369.00	—
Including: Cash from proceeds arising from minority fund		—	—
Cash from borrowings		107,000,000.00	85,000,000.00
Other cash received relating to financing activities		2,220,811.63	2,163,885.27
Sub-total of cash inflows		123,384,180.63	87,163,885.27
Loan interest paid		142,091,000.00	103,000,000.00
Cash payments for distribution of dividends on, profits and payments of interest expenses		6,255,399.97	3,817,587.84
Including: Dividend paid by subsidiaries to minority shareholders		—	—
Other cash paid relating to financing activities		885,043.44	—
Sub-total of cash outflows		149,231,443.41	106,817,587.84
Net cash flows from financing activities		(25,847,262.78)	(19,653,702.57)
4. Effect of foreign exchange rate changes on cash		—	—
5. Net increase in cash and cash equivalents		(28,376,420.62)	(6,896,668.80)

Company's Legal Representative: Lei Jinlu
Financial Controller: Yu Yan
Prepared by: Zhao Qiongfen

CASH FLOW STATEMENT

FOR THE YEAR ENDED 31ST DECEMBER, 2005

SUPPLEMENTARY INFORMATION		Note	The Group	Unit: RMB The Company
1.	Reconciliation of loss to cash flows from operating activities:			
	Net profit		18,321,052.33	20,120,232.17
	Add: Gain or loss of minority shareholders		10,281,126.86	—
	Provision for diminution in value of assets		23,659,676.68	8,077,862.72
	Amortization of deferred income		—	—
	Depreciation of fixed assets		22,987,133.91	18,804,827.97
	Amortization of intangible assets		6,347,276.03	2,189,133.39
	Amortization of long-term deferred expenses		497,762.98	—
	Decrease in deferred expenses (less: increase)		26,575.93	—
	Increase in accrual expenses (less: decrease)		(1,226,137.68)	(386,585.61)
	Loss on disposal of fixed assets, intangible assets and other long-term assets (less: income)		2,879,551.55	(18,887.47)
	Loss on deserted fixed assets		—	—
	Financial expenses		3,686,423.83	2,325,365.23
	Investment loss (less: income)		2,318,901.64	15,851,376.87
	Credit on deferred tax (less: borrowing)		—	—
	Decrease in inventory (less: borrowing)		45,094,962.53	40,180,330.19
	Decrease in operating receivables (less: increase)		(54,307,910.71)	(42,442,060.29)
	Increase in operating payables (less: decrease)		(18,848,554.40)	(10,652,334.48)
	Others		—	—
	Net cash flows from operating activities		61,717,841.48	54,049,260.69
2.	Financing and Investing activities not involving in cash:			
	Debts capitalized		—	—
	Convertible bond due within one year		—	—
	Fixed assets under financial lease		—	—
3.	Net increase in cash and cash equivalents:			
	Cash and bank balances at the end of the period	5.38	157,726,606.62	112,111,009.79
	Less: Cash and bank balances at the beginning of the period	5.38	186,103,027.24	119,007,678.59
	Add: Cash equivalents at the end of the period		—	—
	Less: Cash equivalents at the beginning of the period		—	—
	Net increase in cash and cash equivalents		(28,376,420.62)	(6,896,668.80)

Company's Legal Representative: Lei Jinlu

Financial Controller: Yu Yan

Prepared by: Zhao Qiongfeng

DETAILED SUMMARY OF ALLOWANCE AND IMPAIRMENT OF CONSOLIDATED ASSETS

FOR THE YEAR ENDED 31ST DECEMBER, 2005

Unit: RMB

ITEMS	As 1st January, 2005	Addition this year	Decrease during the year		Total	At 31st December, 2005
			Written back due to the increase of asset value	Reduction/ transfer out this year		
1. Bad debt provision	40,402,559.91	11,121,453.65	–	–	–	51,524,013.56
Comprising: Accounts receivable	34,104,295.02	10,690,745.85	–	–	–	44,795,040.87
Other receivables	6,298,264.89	430,707.80	–	–	–	6,728,972.69
2. Provision for diminution in value of short-term investment	37,545,954.48	699,573.33	–	–	–	38,245,527.81
Comprising: Investment in shares	37,545,954.48	699,573.33	–	–	–	38,245,527.81
Investment in debts	–	–	–	–	–	–
3. Provision of diminution in inventory	34,216,171.48	3,660,275.85	–	6,615,475.26	6,615,475.26	31,260,972.07
Comprising: Finished goods	11,849,261.66	391,676.50	–	–	–	12,240,938.16
Raw materials	4,614,676.29	1,840,836.84	–	350,817.21	350,817.21	6,104,695.92
Work in progress	17,752,233.53	1,427,762.51	–	6,264,658.05	6,264,658.05	12,915,337.99
4. Provision for diminution in value of long-term investment	2,000,000.00	–	–	–	–	2,000,000.00
Comprising: Long-term equity investment	2,000,000.00	–	–	–	–	2,000,000.00
Long-term debt investment	–	–	–	–	–	–
5. Provision for diminution in value of fixed assets	1,948,216.95	4,981,506.65	–	–	–	6,929,723.60
Comprising: Buildings	–	–	–	–	–	–
Plant and machinery	1,524,459.85	4,981,506.65	–	–	–	6,505,966.50
Furniture, fixture and equipment	423,757.10	–	–	–	–	423,757.10
6. Provision for diminution in value of intangible assets	–	5,943,257.64	–	–	–	5,943,257.64
Comprising: Patents	–	4,574,595.82	–	–	–	4,574,595.82
Trademarks	–	1,368,661.82	–	–	–	1,368,661.82
7. Provision for diminution in value of construction in progress	1,635,243.42	935,645.68	–	752,400.00	752,400.00	1,818,489.10
8. Provision for diminution in value of designated loans	–	–	–	–	–	–
9. Total	117,748,146.24	27,341,712.80	–	7,367,875.26	7,367,875.26	137,721,983.78

Company's Legal Representative: Lei Jinlu
Financial Controller: Yu Yan
Prepared by: Zhao Qiongfeng

STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY

FOR THE YEAR ENDED 31ST DECEMBER, 2005

Unit: RMB

ITEMS	The Group		The Company	
	As at 31st December, 2005	As at 31st December, 2004	As at 31st December, 2005	As at 31st December, 2004
1. Issue Share Capital				
At beginning of the year	245,007,400.00	245,007,400.00	245,007,400.00	245,007,400.00
Increase during the year	—	—	—	—
Comprising: Transfer from capital surplus	—	—	—	—
Transfer from statutory surplus reserve	—	—	—	—
Transfer from retained profit	—	—	—	—
Increase in issued share capital	—	—	—	—
Decrease for the year	—	—	—	—
As at year end	<u>245,007,400.00</u>	<u>245,007,400.00</u>	<u>245,007,400.00</u>	<u>245,007,400.00</u>
2. Capital surplus:				
At beginning of the year	305,291,280.12	305,291,280.12	305,291,280.12	305,291,280.12
Increase during the year	8,902,371.51	—	8,902,371.51	—
Comprising: Share premium	—	—	—	—
Donation of non-cash items	—	—	—	—
Cash donation	—	—	—	—
Shares investment reserve	8,902,371.51	—	8,902,371.51	—
Transfer of general funds	—	—	—	—
Exchange reserve	—	—	—	—
Other capital revenue	—	—	—	—
Decrease for the year	—	—	—	—
Comprising: Transfer to capital	—	—	—	—
As at year end	<u>314,193,651.63</u>	<u>305,291,280.12</u>	<u>314,193,651.63</u>	<u>305,291,280.12</u>
3. Statutory and discretionary surplus revenue:				
At beginning of the year	8,406,328.92	8,406,328.92	8,406,328.92	8,406,328.92
Increase during the year	—	—	—	—
Comprising: Transfer from retained earnings	—	—	—	—
Comprising: Statutory surplus reserve	—	—	—	—
Discretionary surplus reserve	—	—	—	—
General reserve fund	—	—	—	—
Enterprise development fund	—	—	—	—
Transfer from statutory public welfare fund	—	—	—	—
Decrease for the year	—	—	—	—
Comprising: Loss	—	—	—	—
Transfer of share capital	—	—	—	—
Distribution of dividend or profits	—	—	—	—
Distribution of stock dividend	—	—	—	—
As at year end	<u>8,406,328.92</u>	<u>8,406,328.92</u>	<u>8,406,328.92</u>	<u>8,406,328.92</u>
Comprising: Statutory surplus reserve	<u>8,406,328.92</u>	<u>8,406,328.92</u>	<u>8,406,328.92</u>	<u>8,406,328.92</u>
General reserve fund	—	—	—	—
Enterprise development fund	—	—	—	—
4. Statutory public welfare fund				
At beginning of the year	8,406,328.92	8,406,328.92	8,406,328.92	8,406,328.92
Increase during the year	—	—	—	—
Comprising: Transfer from retained earnings	—	—	—	—
Decrease for the year	—	—	—	—
As at year end	<u>8,406,328.92</u>	<u>8,406,328.92</u>	<u>8,406,328.92</u>	<u>8,406,328.92</u>
5. Retained profit (loss):				
At beginning of the year	(62,340,523.65)	(45,259,474.24)	(62,340,523.65)	(45,259,474.24)
Net profit (loss) for the year	18,321,052.33	(17,081,049.41)	20,120,232.17	(17,081,049.41)
Appropriation	—	—	—	—
As at year end	<u>(44,019,471.32)</u>	<u>(62,340,523.65)</u>	<u>(42,220,291.48)</u>	<u>(62,340,523.65)</u>

Company's Legal Representative: Lei Jinlu
Financial Controller: Yu Yan
Prepared by: Zhao Qiongfeng

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2005

(1) GENERAL

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

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

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

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

On 15th September, 2005, Xian Jiaotong University Industrial (Group) Incorporation and Shenyang Machine Tool (Group) Company Limited signed an agreement regarding transfer of shares. Shenyang Machine Tool (Group) Company Limited agreed to buy 71,052,146 shares of Jiaoda High-tech Company Limited from Xian Jiaotong University Industrial (Group) Incorporation. The number of shares transferred is 29% of the total 245,007,400 shares. As of 31st December, 2005, the acquisition is still pending for approval.

(2) SIGNIFICANT ACCOUNTING POLICIES, ACCOUNTING ESTIMATES AND PREPARATION OF FINANCIAL STATEMENTS

1. Accounting Standards and Accounting System

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

2. Accounting Fiscal Year

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

3. Reporting Currency

The reporting currency of the Company is Renminbi (“RMB”).

4. Recording Principles and Accounting Basis

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

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2005

(2) SIGNIFICANT ACCOUNTING POLICIES, ACCOUNTING ESTIMATES AND PREPARATION OF FINANCIAL STATEMENTS *(Continued)*

5. Foreign Currency Translation

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

6. Recognition Criteria for Cash Equivalents

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

7. Accounting for Bad Debts

(1) Recognition criteria for bad debt

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

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

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

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

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

8. Accounting for Inventories

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

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

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2005

(2) SIGNIFICANT ACCOUNTING POLICIES, ACCOUNTING ESTIMATES AND PREPARATION OF FINANCIAL STATEMENTS *(Continued)*

9. Accounting for Short-term Investment

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

10. Accounting for Long-term Investment

- (1) Long-term bond investment

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

- (2) Long-term equity investment

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

- (3) Method of amortizing equity investment difference

The debit balance of the equity investment difference is amortized on a straight-line basis for the terms in investment as stated in the contract and charged to the profit and loss account. If there is no specific term stated in the contract, amortization is carried out over within 10 years; the credit balance of the equity investment difference is recorded in the account of capital reserve-provision for equity investment

- (4) If the recoverable amount of any long-term equity investment is lower than the carrying amount of that investment as a result of a continuing decline in market value or changes in operating conditions of investee enterprises and the reduced value cannot be recovered in the foreseeable future period, provision should be made for the difference between the recoverable amount and the carrying amount of the investment.

11. Accounting for and Depreciation of Fixed Assets

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

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

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

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2005

(2) SIGNIFICANT ACCOUNTING POLICIES, ACCOUNTING ESTIMATES AND PREPARATION OF FINANCIAL STATEMENTS *(Continued)*

11. Accounting for and Depreciation of Fixed Assets *(Continued)*

(4) Provision on impairment loss on fixed assets

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

- (i) Fixed assets have been idled for a long period of time and will not be reused in the foreseeable future. They have no transfer value as well;
- (ii) Fixed assets cannot be utilized because of their obsolete technology;
- (iii) Large quantity of unqualified products are produced when fixed assets are used.
- (iv) Fixed assets have been damaged and have no usage value and transfer value.
- (v) Fixed assets in substance cannot produce economic benefits for the Company.

12. Accounting for Construction in Progress

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

Provision on impairment loss on construction in progress

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

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

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

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2005

(2) SIGNIFICANT ACCOUNTING POLICIES, ACCOUNTING ESTIMATES AND PREPARATION OF FINANCIAL STATEMENTS *(Continued)*

13. Intangible Assets

(1) Amortisation of intangible assets

- (i) If the contract stipulates the benefiting period and the law does not prescribe the effective period, intangible assets are amortised over the effective period;
- (ii) If the contract does not stipulate the benefiting period and the law prescribes the effective period, intangible assets are amortised over the effective period;
- (iii) If the contract stipulates the benefiting period and the law prescribes the effective period, intangible assets are amortised over the shorter of the benefiting period and the effective period;
- (iv) If the contract does not stipulate the benefiting period and the law does not prescribe the effective period, intangible assets are amortised over 10 years.

(2) Provision on impairment loss on intangible assets

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

- (i) one term of intangible assets has been replaced by other new technology and its ability of producing economic benefits has been affected significantly;
- (ii) the market value of one item of intangible assets drops sharply in the current period and is expected to be non-recoverable in the rest of the year;
- (iii) one item of intangible assets unprotected by the law still has usage value;
- (iv) other evidence indicates the loss on value of intangible assets.

14. Amortization of Initial Expenses and Long-term Deferred Expenditure

- (i) Initial cost is fully charged to income in the current month when operations begin;
- (ii) Long-term deferred expenditures are evenly amortised during the benefiting period.

15. Borrowing Cost

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

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

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2005

(2) SIGNIFICANT ACCOUNTING POLICIES, ACCOUNTING ESTIMATES AND PREPARATION OF FINANCIAL STATEMENTS *(Continued)*

16. Accounting for Bonds Payables

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

17. Recognition Criteria for Revenue

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

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

(4) Revenue from Finance Leases and Operating Leases

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

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

(iii) Sale and leaseback transactions

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

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2005

(2) SIGNIFICANT ACCOUNTING POLICIES, ACCOUNTING ESTIMATES AND PREPARATION OF FINANCIAL STATEMENTS *(Continued)*

18. Accounting for Income Taxes

Income taxes are calculated using the taxes receivable method.

19. Tax Refund

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

20. Basis of Consolidation

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

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

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

- (i) equity investment of the Company and relevant parts of ownership interests of subsidiaries in the scope of consolidation.
- (ii) all significant inter-company transactions and balances between the Company and subsidiaries in the scope of consolidation.

(3) TAXATION

1. Value Added Tax (VAT)

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

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

2. Income Tax

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

Shanxi Hengtong Intelligent Machine Company Limited, Xian Jiaotong University Siyuan Intelligent Electric Apparatus Company Limited, Xian Ser Turbo Machinery Company Limited and Winko Machines Company Limited are all high-tech companies. The applicable income tax rate for them is 15%.

3. Business Tax

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

4. Other taxes

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

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2005

(4) SUBSIDIARIES AND JOINT VENTURES

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

Name of subsidiaries and joint ventures	Place of Registration	Scope of Business	Registered Capital RMB'000	Investment Proportion (%)	Nature	Date of Investment	Relationship with the Company
Xian Ser Turbo Machinery Company Limited ("Xian Ser")	Xian City	Design, develop and sales of turbo-machinery.	5,000	45.00%	Limited liability	December 2001	Subsidiary
Shanxi Hengtong Intelligent Company Limited ("Shanxi Hengtong")	Xian City	Develop and sales of machine manufacturing moulds, machinery, equipment, electronic products, software and hardware.	2,796	65.34%	Limited liability	December 2001	Subsidiary
Xian Jiaotong University Siyuan Intelligent Electric Apparatus Company Limited	Xian City	Develop, manufacture and sale of electronic products, electronic machine and products of electronic power; Provide technology services.	3,500	78.03%	Limited liability	December 2002	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.	2,023	95.50%	Limited liability	November 2002	Subsidiary
TOS Kunming Machine Tool Company Limited	Kunming City	Develop, design, manufacture and sales of turbo machines and high-tech products; and repairs of machines.	5 million Euros	50.00%	Limited liability	April 2005	Joint Venture
Changsha Ser Turbo Machinery Equipment Company Limited ("Changsha Ser")	Changsha City	Design, develop and sales of turbo machinery.	1,000	95.00%	Limited liability	January 2004	Subsidiary of Xian Ser
Hangzhou Ser Gas Engineering Company Limited ("Hangzhou Ser")	Hangzhou City	Design, develop and sales of turbo machinery; technology development; retail and wholesales of construction materials; and import and export business.	120	51.00%	Limited liability	April 2004	Subsidiary of Xian Ser

(2) Except TOS Kunming, all the above companies are included in the consolidated financial statements.

During the year, Xian Ser transfers the capital reserve, surplus reserve and unappropriated profit to increase its capital to RMB50,000,000. The shareholding of the Company is 45%. Since the majority of the Board of Directors of Xian Ser are from the Company, Xian Ser is included in the consolidated financial statements this year.

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

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2005

(4) SUBSIDIARIES AND JOINT VENTURES (Continued)

According to the contract signed on 26th December, 2005 between Xian Ser and Sichuan Air Separation Plant (Group) Co. Ltd., termination of business of 四川交大賽爾川空透平機械有限公司 is agreed by both parties Sichuan Air Separation Plant (Group) Co. Ltd. is responsible for the termination issue and the capital contributed by Xian Ser has been repaid by Sichuan Air Separation Plant (Group) Co. Ltd..

On 4th April, 2005, TOS Kunming Machine Tool Company Limited is established by the contribution of capital by the Company and Tos Varnsdorf, A.S.. The registered capital is EUR5,000,000. The Company owns 50% of capital but not the controlling right, thus, the jointly controlled entity is not included in the consolidated financial statement.

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

1. Bank Balances and Cash

Items	At 31st December, 2005		At 1st January, 2005	
	Foreign currency	RMB	Foreign currency	RMB
Cash on hand		774,069.45		972,922.67
RMB		505,665.89		706,897.76
HKD	29,934.64	31,146.99	29,935.00	31,841.90
USD	27,847.15	224,751.56	27,347.15	226,338.68
IDR	390,000.00	320.97	390,000.00	390.00
EUR	1,271.86	12,184.04	661.86	7,454.33
Bank		154,843,663.83		188,130,104.57
RMB		125,959,318.36		155,631,380.36
Including: time deposit				18,000,000.00
HKD	26,969,960.44	28,062,243.84	28,972,455.61	30,818,001.03
Including: time deposit			25,000,000.00	26,592,500.00
USD	101,859.97	822,101.63	203,071.73	1,680,723.18
Other currencies		16,258,338.12		7,564,260.00
Total		171,876,071.40		196,667,287.24

Note:

The cash in other currencies as at 31st December, 2005 included the restricted bank deposit (premium of guarantee letter).

2. Short-term Investment

Items	At 31st December, 2005		At 1st January, 2005	
	Amount	Provision	Amount	Provision
Share investment	50,000,000.00	38,097,597.20	50,000,000.00	37,480,416.81
Unit fund	1,000,000.00	128,768.95	1,000,000.00	65,537.67
Total	51,000,000.00	38,226,366.15	51,000,000.00	37,545,954.48

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2005

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

Note:

In February 2004, the Company entered into an agreement with China Fortune Securities ("China Fortune") for the Trusteeship of the Management of Investment in State Bonds (the "Trusteeship Agreement") pursuant to which the Company entrusted China Fortune to conduct investment on State Bonds with RMB50,000,000 (the "Fund") but China Fortune diverted the Fund to invest in several stocks. China Fortune was under the control of 德隆系證券公司 and in June 2004, it was taken over in custody by China Huarong Asset Management Corporation ("China Huarong"). Approved by the China Regulatory Commission, in January 2006, Capital Airport Holding Company started the restructuring process of China Fortune. The Company is currently in negotiation with China Fortune for the repayment of the Funds. Because of the uncertainty of the recoverability of the Funds, the Company decided to recognize an impairment loss of RMB38,097,597.20, based on the market value of RMB4,250,000 of the Funds on 31st December, 2005.

3. Bill Receivable

Items	At 31st December, 2005	At 1st January, 2005
Bank acceptance notes	19,057,802.00	17,947,434.06
Total	<u>19,057,802.00</u>	<u>17,947,434.06</u>

4. Accounts Receivable

Aged analysis	At 31st December, 2005			At 1st January, 2005		
	Amount	Proportion (%)	Bad debt provision	Amount	Proportion (%)	Bad debt provision
Within 1 year	68,507,547.34	52.18	2,900,089.10	65,764,693.17	58.83	2,690,505.48
1-2 years	32,140,167.61	24.48	14,163,940.76	23,768,131.94	21.26	10,217,964.96
2-3 years	11,873,909.73	9.04	10,252,661.79	6,906,229.99	6.18	6,056,229.99
Over 3 years	18,778,654.39	14.30	17,478,349.22	15,343,099.53	13.73	15,139,594.59
Total	<u>131,300,279.07</u>	<u>100.00</u>	<u>44,795,040.87</u>	<u>111,782,154.63</u>	<u>100.00</u>	<u>34,104,295.02</u>

Note:

(i) The details regarding amount due from shareholders whose shares exceed 5% (including 5%) of the total shares of the Company are shown in Note 7 "RELATED PARTY RELATIONSHIP AND TRANSACTION".

(ii) The total amount of the 5 largest debtors is RMB13,917,225.30, constituting 10.60% of the total amount of accounts receivable.

5. Other Receivables

Aged analysis	At 31st December, 2005			At 1st January, 2005		
	Amount	Proportion (%)	Bad debt provision	Amount	Proportion (%)	Bad debt provision
Within 1 year	24,785,559.15	81.17	1,318,722.58	11,382,463.48	64.61	1,821,679.61
1-2 years	1,934,311.49	6.33	875,881.25	4,034,428.84	22.90	2,721,038.01
2-3 years	2,867,067.41	9.39	2,867,067.41	158,957.80	0.90	158,957.80
Over 3 years	948,361.45	3.11	1,667,301.45	2,041,919.47	11.59	1,596,589.47
Total	<u>30,535,299.50</u>	<u>100.00</u>	<u>6,728,972.69</u>	<u>17,617,769.59</u>	<u>100.00</u>	<u>6,298,264.89</u>

Note:

(i) The details regarding amount due from shareholders whose share exceed 5% (including 5%) of the total shares of the Company is shown in Note 7 "RELATED PARTY RELATIONSHIP AND TRANSACTION".

(ii) The total amount of other receivables from the 5 largest debtors is RMB14,151,320.00, constituting 46.34% of the total amount of accounts receivables.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2005

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

6. Prepayments

Aged analysis	At 31st December, 2005		At 1st January, 2005	
	Amount	Proportion (%)	Amount	Proportion (%)
Within 1 year	20,588,757.92	78.86	57,495,083.37	93.52
1-2 years	5,419,311.65	20.76	3,881,963.98	6.31
2-3 years	99,119.78	0.38	106,611.96	0.17
Over 3 years	0.00	0.00	—	—
Total	26,107,189.35	100.00	61,483,659.31	100.00

Note:

- (i) The details regarding prepayments to shareholders whose share exceed 5% (including 5%) of the total shares of the Company are shown in Note 7 "RELATED PARTY RELATIONSHIP AND TRANSACTION".
- (ii) As at 31st December, 2005, the amount of prepayments decreased by 57.54% compared with the end of last year. This is mainly because Xian Ser, one of the subsidiaries of the Company, has shortened its settlement periods with suppliers, resulting in a large decrease in prepayments.

7. Inventories

Items	At 31st December, 2005		At 1st January, 2005	
	Amount	Provision for loss on realization	Amount	Provision for loss on realization
Finished goods	84,455,621.48	11,180,530.82	121,982,886.61	11,722,480.66
Raw materials	51,256,666.00	6,589,220.48	48,095,775.32	4,015,433.51
Consumables	3,491,446.34	82,781.00	3,021,539.79	106,141.00
Work in progress	163,602,559.92	12,915,337.99	183,021,979.37	17,752,233.53
Materials purchased	525,620.78	493,101.78	493,101.78	493,101.78
Inventory	2,005,569.29	—	255,535.05	—
Goods Sold	426,174.15	—	816,489.98	126,781.00
Total	305,763,657.96	31,260,972.07	357,687,307.90	34,216,171.48

8. Long-term Equity Investment

- (1) General of investee enterprises

Name of Investee	Initial investment cost	Investment proportion	Investment period	Accounting method
Yunnan Cheng Jiang Copper Products Plant	2,000,000	40.00%	Nil	Cost method
TOS Kunming Machine Tool Company Limited	24,739,533.99	50.00%	20 years	Equity method

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2005

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

8. Long-term Equity Investment (Continued)

(2) Changes in long-term equity investment

Name of Investee	At 1st January, 2005	Changes in current year		Changes in accumulated equity		At 31st December, 2005
		Investment cost	Equity adjustment	Investment Cost	Equity adjustment	
Yunnan Cheng Jiang Copper Products Plant	2,000,000.00	—	—	—	—	2,000,000.00
TOS Kunming Machine Tool Company Limited	—	24,739,533.99	(920,719.24)	—	—	23,818,814.75
Less: Provision for diminution in value of long-term equity investment	2,000,000.00	—	—	—	—	2,000,000.00
Total	—	24,739,533.99	(920,719.24)	—	—	23,818,814.75

(3) Difference in long-term equity investment

Name of Investor	Initial investment cost	At 1st January, 2005	Addition in the current period	Amortization in the current period	At 31st December, 2005	Amortization period
Xian Ser	7,296,277.00	5,107,393.84	—	729,627.72	4,377,766.12	10 years
Shanxi Hengtong	6,849,713.19	4,680,693.43	—	668,554.68	4,012,138.75	10 years
Total	14,145,990.19	9,788,087.27	—	1,398,182.40	8,389,904.87	

Note:

(1) Full provision for impairment on long-term investment of Yunnan Cheng Jiang Copper Products Plant was made because the plant has lost of the ability of sustainable operation.

(2) There is no significant difference between the accounting policies used by the investee enterprises and that used by the Company. There is no significant restrictions to realization of investment and investment income outflow as foreign currency.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2005

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

9. Fixed Assets and Accumulated Depreciation

Category	At 1st January, 2005	Increase this year	Decrease this year	At 31st December, 2005
Buildings	159,819,004.68	55,611,119.53	12,807,521.59	202,622,602.62
Furniture, fixtures and equipment	37,483,201.81	1,985,568.79	257,528.20	39,211,242.40
Plant and machinery	239,411,172.13	27,157,617.68	3,891,139.49	262,677,650.32
Motor vehicles	18,814,797.05	2,955,040.46	1,583,152.80	20,186,684.71
Leasehold improvement	1,263,823.11	—	—	1,263,823.11
Sub-total	456,791,998.78	87,709,346.46	18,539,342.08	525,962,003.16
ACCUMULATED DEPRECIATION:				
Buildings	28,411,501.26	6,175,624.27	1,394,095.34	33,193,030.19
Furniture, fixtures and equipment	20,706,314.20	3,137,815.28	179,347.50	23,664,781.98
Plant and machinery	108,851,463.65	14,369,867.37	520,820.65	122,700,510.37
Motor vehicles	6,290,656.61	2,019,261.57	428,606.93	7,881,311.25
Leasehold improvement	509,340.92	316,635.70	—	825,976.62
Sub-total	164,769,276.64	26,019,204.19	2,522,870.42	188,265,610.41
Net book value	292,022,722.14	61,690,142.27	16,016,471.66	337,696,392.75
PROVISION FOR IMPAIRMENT:				
Buildings	—	—	—	—
Furniture, fixture and equipment	423,757.10	—	—	423,757.10
Plant and machinery	1,524,459.85	4,981,506.65	—	6,505,966.50
Motor vehicles	—	—	—	—
Sub-total	1,948,216.95	4,981,506.65	—	6,929,723.60
NET REALIZABLE VALUE	290,074,505.19	56,708,635.62	16,016,471.66	330,766,669.15

Note:

- (1) Provision on impairment is recognized when the book value is higher than the net realizable value.
- (2) Buildings amounting to RMB46,192,910.56 in original cost and RMB44,201,292.56 in net realizable value have been pledged to secure loans.
- (3) The original book value of fixed assets from finance leases is RMB4,264,181.00. The amount of accumulated depreciation is RMB2,624,700.96 and the net realizable value is RMB1,639,480.04 accordingly.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2005

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

10. Construction in Progress

Construction name	At 1st January, 2005	Additions this year	Transfer to fixed assets	Other transfer out	At 31st December, 2005	Source of funds
95 Technical improvement projects	4,814,859.38	19,802,593.34	24,566,530.89	—	50,921.83	Loans
Including: Capitalised interest	1,421.94	—	1,421.94	—	—	Loans
Resources Office Building	22,219,562.74	5,804,536.36	—	—	28,024,099.10	Funds owned
New factory	25,602,226.30	6,611,136.21	32,213,362.51	—	—	Funds owned
Others	7,375,289.19	37,071,194.62	24,099,197.67	9,499.83	20,337,786.31	Funds owned
Total	60,011,937.61	69,289,460.53	80,879,091.07	9,499.83	48,412,807.24	
Less: provision on impairment loss on construction in progress	1,635,243.42	935,645.68	—	752,400.00	1,818,489.10	
NET REALIZABLE VALUE	58,376,694.19	68,353,814.85	80,879,091.07	(742,900.17)	46,594,318.14	

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2005

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

11. Intangible Assets

Items	Acquired method	Original cost	At 1st January, 2005	Addition this year	Transfer out this year	Amortization this year	At 31st December, 2005	Remaining amortisation period
Goodwill (Note 1)	Acquisition of business	5,638,632.00	3,947,042.68	–	–	563,863.20	3,383,179.48	6
Goodwill (Note 2)	Acquisition of business	3,720,569.00	2,604,398.35	–	–	372,056.94	2,232,341.41	6
The all over controlled vortex technology		11,630,000.00	8,140,999.88	–	–	1,163,000.04	6,977,999.84	6
Technical know-how of fast moulding		14,730,000.00	10,310,999.50	–	–	1,473,000.00	8,837,999.50	6
Intelligent know-how		9,044,400.00	6,331,080.02	–	–	904,440.00	5,426,640.02	6
Technical know-how of embroidery machine		4,039,667.00	2,804,973.09	–	–	403,966.67	2,401,006.42	6.75
Land use right	Contributed	30,141,860.00	26,566,252.10	–	–	674,167.04	25,892,085.06	42.95
Usage right to staff quarter	Acquisition of business	4,485,988.00	3,644,866.01	–	–	93,458.04	3,551,407.97	3
Financial software	Acquisition of business	1,227,258.23	717,208.23	510,050.00	–	305,300.67	921,957.56	
Company website development expenses	Acquisition of business	38,000.00	21,533.42	–	–	7,599.96	13,933.46	6.58
95 Technical improvement software		1,753,662.85	255,248.77	1,259,632.85	–	299,429.64	1,215,451.98	3.5
Sub-total		86,450,037.08	65,344,602.05	1,769,682.85	–	6,260,282.20	60,854,002.70	
Less: Provision on intangible assets								
Goodwill (Note 1)		–	–	676,635.90	–	–	676,635.90	
Goodwill (Note 2)		–	–	692,025.92	–	–	692,025.92	
Intelligent know-how		–	–	2,713,320.01	–	–	2,713,320.01	
Technical know-how of embroidery machine		–	–	1,861,275.81	–	–	1,861,275.81	
Sub-total		–	–	5,943,257.64	–	–	5,943,257.64	
NET REALIZABLE VALUE		86,450,037.08	65,344,602.05	(4,173,574.79)	–	6,260,282.20	54,910,745.06	

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2005

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

11. Intangible Assets (Continued)

Note:

- (1) Goodwill is made for the difference between the transaction price and the book value when Xian Jiaotong University Industrial Group acquired two subsidiaries from Intelligent Electronic Machine and Automatic Machine, in December 2001 during the course of the assets restructuring. The company made the investment of the assets in the two subsidiaries and relevant goodwill stated above and established Xian Jiaotong University Siyuan Intelligent Electric Apparatus Company Limited and Winko Machines Company Limited in this year. These two items of goodwill are amortised over 10 years.
- (2) Technical know-how is that the Company acquired from Xian Jiaotong University Industrial Group in December 2001 during the course of the assets restructuring. The Company made the investment of "Intelligent Technical Know-how" and "Embroidery Machine Technical Know-how" and established Xian Jiaotong University Siyuan Intelligent Electric Apparatus Company Limited and Winko Machines Company Limited. In 2003, the capital injection of the Company in Shaxi Hengtong was based on the carrying value of "Fast Moulding Technical Know-how".
- (3) Land use right was contributed by Yunnan Government as capital. The addition for current period was due to the purchase of land for Changsha Ser.
- (4) Land use right amounting to RMB13,586,764.80 has been pledged to secure loans.

12. Short-term Loans

Currency: RMB		
Category	At 31st December, 2005 Amount	At 1st January, 2005 Amount
Guaranteed loans	—	39,091,000.00
Secured loans	34,000,000.00	44,000,000.00
Credit loans	26,000,000.00	54,000,000.00
Total	60,000,000.00	137,091,000.00

Note:

All the secured bank loans are secured by buildings and land use right in possession of the Company and its subsidiary, Changsha Ser, details refer to note 5.9(3) and 5.11(4).

13. Accounts payables

As at 31st December, 2005 and at 31st December, 2004, the balance of accounts payables amounts to RMB100,037,194.40, RMB62,640,557.32 respectively. The balance of accounts payables contain no amounts due to shareholders whose shares exceeds 5%(including 5%) of total shares of the Company.

14. Advances from Customers

- (1) As at 31st December, 2005 and at 31st December, 2004, the balance of advances from customers amounts to RMB196,375,494.03, RMB294,381,649.15 respectively, representing a decrease of 33.29%. The main reason for the decrease was the completion of sales orders of the Company and Xian Ser, one of subsidiaries of the Company.
- (2) No advances from shareholders whose shares exceed 5% (including 5%) of total shares of the Company.

15. Accrued Salary

Accrued salary is made for the salary due to employees of the Company. As at 31st December, 2005 and at 31st December, 2004, the balance of accrued salary totals up to RMB3,574,234.94 and RMB2,401,981.42 respectively.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2005

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

16. Taxes Payables

Items	At 31st December, 2005	At 1st January, 2005
Value added tax	14,647,753.61	9,585,420.91
Business tax	272,831.85	304,763.85
City construction tax	196,105.13	40,917.73
Income tax	5,730,376.03	4,584,707.72
Personal income tax	384,162.26	241,639.14
Land Appreciation Tax	8,984,000.00	—
Others	21,885.07	1,446.73
Total	<u>30,237,113.95</u>	<u>14,758,896.08</u>

Note:

Detail of Land Appreciation Tax (LAT), please refer to point 1 on "other important event" in note 12.

17. Other Payables

Items	At 31st December, 2005	At 31st January, 2005
Additional educational fee	178,833.24	15,712.47
Flood-controlling funds	16,302.78	423.86
Housing funds	568,537.40	449,815.00
Total	<u>763,673.42</u>	<u>465,951.33</u>

18. Other Accrual

As at 31st December, 2005 and at 31st December, 2004, the balance contains RMB29,713,624.55 and RMB25,250,268.44 respectively. The details of balance due to shareholders whose shares exceed 5% (including 5%) of total shares of the Company are disclosed in Note 7 "Connected Party Relationship and Transaction".

19. Accrued Expenses

Items	At 31st December, 2005	At 1st January, 2005
Accrued rental	74,516.28	61,888.00
Accrued audit fee	1,272,915.45	1,727,814.33
Accrued water and electricity fee	94,781.72	231,327.90
Accrued consulting fee, legal fee etc.	120,000.00	51,686.73
Others	—	—
Total	<u>1,562,213.45</u>	<u>2,072,716.96</u>

20. Long-term Loans Due Within One Year

Items	At 31st December, 2005	At 1st January, 2005
Obligation under finance leases due within 1 year	<u>342,168.90</u>	<u>342,168.90</u>

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2005

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

21. Long-term Loans

Currency: RMB

Category	At 31st December, 2005 Amount	At 1st January, 2005 Amount
Credit loans	40,000,000.00	—

22. Long-term payable

Category	Period	Original amount	At 1st January, 2005	Increase in this year	Decrease in this year	At 31st December, 2005
Obligation under finance lease	20 years	6,843,378.00	5,816,871.30	—	342,168.90	5,474,702.40
Less: future finance charge		2,579,197.00	2,192,317.60	—	128,959.80	2,063,357.80
Less: amount due for settlement within one year		—	342,168.90	—	—	342,168.90
Sub-total		4,264,181.00	3,282,384.80	0.00	213,209.10	3,069,175.70
Add: infrastructure construction appropriation from the Office of Finance of Shanxi Province		—	200,000.00	—	—	200,000.00
Appropriation for intelligent electronic machine industrialization exemplary projects technology and equipment technology		—	7,000,000.00	—	—	7,000,000.00
Total		4,264,181.00	10,482,384.80	0.00	213,209.10	10,269,175.70

Note:

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

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2005

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

23. Specific Project Payables

Items	At 31st December, 2005	At 1st January, 2005
Specific project appropriation from the Science and Technology Committee of Yunnan Province	2,675,616.01	2,647,563.01
Specific project appreciation for industrial automation from Shanxi Provincial Development and Reform Commission	4,007,012.77	—
Specific project appreciation from Shanxi Intellectual Property Office	100,000.00	—
Total	<u>6,782,628.78</u>	<u>2,647,563.01</u>

24. Deferred Gain

Items	Original amount	At 1st January, 2005	Addition this year	Provided for the year	Accumulated amortization	Transfer out this year	At 31st December, 2005
Buildings	4,023,642.00	2,670,192.21	—	—	—	2,670,192.21	—
Including:							
Operating lease	1,758,331.00	1,494,582.14	—	—	—	1,494,582.14	—
Finance lease	2,265,311.00	1,175,610.07	—	—	—	1,175,610.07	—
Land use right	8,287,344.00	7,044,202.74	—	—	—	7,044,202.74	—
Including:							
Operating lease	8,287,344.00	7,044,202.74	—	—	—	7,044,202.74	—
Finance lease	—	—	—	—	—	—	—
Total	<u>12,310,986.00</u>	<u>9,714,394.95</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>9,714,394.95</u>	<u>—</u>

Note:

The Company leased back a portion of land use right and premise use right which had been disposal to Yunnan Government in December 2001 when the Company implemented the assets restructuring. The lease term is 20 years. The selling price of these assets is RMB28,438,361 and the book value of these assets is RMB16,127,375. The gain due from the transactions of RMB12,310,986 is to be deferred. For operating lease, deferred gain is to be allocated through the lease period according to rental expenses; For finance lease, deferred gain is to be allocated to adjust depreciation expense according to depreciation rate. According to Document No. 6 in 2005, "In Response to the Land Appreciation Tax Policy regarding Capital Restructuring between Jiaoda Kunji High-Tech Company Limited and Xian Jiaotong University Industrial (Group) Incorporation" issued by Tax Policy Department, Ministry of Finance of People Republic of China in March 2005, the Company should pay for land appreciation tax regarding the above issue. This item would be provided for during the year. Detail refers to item 1 of "Other Important Events" in note 12.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2005

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

25. Share Capital

Items	At 1st January, 2005	Increase in this year	Decrease in this year	At 31st December, 2005
1. Non-trading shares	120,007,400.00	—	—	120,007,400.00
Promoters shares	31,345,554.00	—	—	31,345,554.00
Including: State-Owned shares	31,345,554.00	—	—	31,345,554.00
Legal person shares	88,661,846.00	—	—	88,661,846.00
2. Trading shares	125,000,000.00	—	—	125,000,000.00
Including: A shares	60,000,000.00	—	—	60,000,000.00
H shares	65,000,000.00	—	—	65,000,000.00
Total shares	<u>245,007,400.00</u>	<u>—</u>	<u>—</u>	<u>245,007,400.00</u>

26. Capital Reserve

Items	At 31st December, 2005	At 1st January, 2005
Share premium	293,744,338.00	293,744,338.00
Revaluation surplus	11,536,142.12	11,536,142.12
Provision for equity investment	8,902,371.51	—
Donation	10,800.00	10,800.00
Total	<u>314,193,651.63</u>	<u>305,291,280.12</u>

Note:

Regarding the investment in TOS Kunming of the Company during the year, a difference of RMB8,868,576.33 between book value of fixed assets and actual investment amount is identified and classified under provision for equity investment. The Company's capital reserve is increased by RMB33,795.18 from income derived from debt restructuring of its subsidiaries.

27. Surplus Reserve

Items	At 1st January, 2005	Increase in this year	Decrease in this year	At 31st December, 2005
Statutory surplus reserve	8,406,328.92	—	—	8,406,328.92
Statutory public reserve	8,406,328.92	—	—	8,406,328.92
Total	<u>16,812,657.84</u>	<u>—</u>	<u>—</u>	<u>16,812,657.84</u>

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2005

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

28. Unappropriated Profit

Items	Year 2005
Retained profit at the beginning of the year	(62,340,523.65)
Add: Net profit this year	18,321,052.33
Less: Statutory surplus reserve	—
Statutory public reserve	—
Retained profit at the year end	<u>(44,019,471.32)</u>

29. Principal Operation Income and Cost

Items	2005 (Accumulated)		2004 (Accumulated)	
	Revenue	Cost	Revenue	Cost
Machine tool	396,844,720.66	302,532,952.43	262,246,383.68	191,337,032.68
High-effective energy-saving compressors	209,774,250.37	157,524,813.18	137,452,140.23	103,510,753.43
Embroidery machine	1,885,824.73	2,802,388.67	15,223,136.07	10,215,171.15
Intelligent electric appliance	9,972,656.50	5,046,630.64	10,328,182.13	5,241,034.71
Machine processing service	27,968,233.00	12,688,070.98	14,708,642.40	11,012,318.54
Laser prototyping system	12,795,896.53	9,129,851.13	13,404,104.84	8,097,121.00
Precision measuring equipment	8,226,629.05	3,549,971.21	5,366,865.09	2,863,439.08
Others	5,174,713.02	2,251,790.25	10,706,915.92	6,820,905.79
Total	<u>672,642,923.86</u>	<u>495,526,468.49</u>	<u>469,436,370.36</u>	<u>339,097,776.38</u>

Note:

Total sales of the 5 largest customers total up to RMB73,248,190.00 which constitutes 10.89% of total sales of the Company.

30. Principal Operation Tax and Addition

Items	2005 (Accumulated)	2004 (Accumulated)
Business tax	(13,060.34)	47,050.44
City construction tax	1,130,424.59	106,308.81
Education fee addition	709,470.31	46,746.68
Total	<u>1,826,834.56</u>	<u>200,105.93</u>

Note:

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

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2005

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

31. Profit from Other Operations

Items	Income	Cost	Profit
Materials sold	671,379.34	2,420,952.00	(1,749,572.66)
Rental income	333,082.47	369,215.28	(36,132.81)
Base materials	1,156,381.57	—	1,156,381.57
Technical services	164,976.31	19,120.00	145,856.31
Total	<u>2,325,819.69</u>	<u>2,809,287.28</u>	<u>(483,467.59)</u>

32. Finance Expenses

Items	2005 (Accumulated)	2004 (Accumulated)
Interest expenses	6,056,200.39	7,486,446.86
Less: Interest income	3,155,867.34	1,270,224.67
Exchange loss	489,252.11	73,410.42
Bank processing fee	213,123.76	104,548.35
Others	128,959.80	128,959.80
Total	<u>3,731,668.72</u>	<u>6,523,140.76</u>

Note:

Due to decrease in loans and increase in interest income during the year, finance expenses of the Company decreases.

33. Investment Income

Items	2005 (Accumulated)	2004 (Accumulated)
Equity investment income	(920,719.24)	—
Amortisation of equity investment difference	(1,398,182.40)	(1,398,182.40)
Provision for diminution in value of short-term investment	(680,411.67)	(37,545,954.48)
Income from short-term investment	—	808,092.39
Total	<u>(2,999,313.31)</u>	<u>(38,136,044.49)</u>

34. Subsidies

Items	2005 (Accumulated)	2004 (Accumulated)
Income tax refunded	2,922,171.67	2,654,766.16
Total	<u>2,922,171.67</u>	<u>2,654,766.16</u>

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2005

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

35. Non-operating Income

Items	2005 (Accumulated)	2004 (Accumulated)
Gain on disposal of fixed assets	225,813.28	106,162.81
Income from provision of training	—	19,550.00
Others	146,867.00	140,350.00
Total	<u>372,680.28</u>	<u>266,062.81</u>

36. Non-operating Expenses

Items	2005 (Accumulated)	2004 (Accumulated)
Loss on disposal of fixed assets	2,576,585.95	113,577.85
Contribution expenses	28,000.00	71,500.00
Provision on impairment loss on fixed assets	4,229,106.65	—
Provision on impairment loss on construction-in progress	935,645.68	983,646.35
Provision on impairment loss on intangible asset	5,943,257.64	—
Others	70,471.23	63,234.84
Total	<u>13,783,067.15</u>	<u>1,231,959.04</u>

37. Income Taxes

Income taxes of RMB9,751,501.09 represent income taxes paid by the Company and Xian Ser.

38. Cash and cash equivalent

Items	At 31st December, 2005		At 1st January, 2005	
	Consolidated amount	Amount for the Company	Consolidated amount	Amount for the Company
Cash	171,876,071.40	116,260,474.57	196,667,287.24	121,861,338.59
Less: time deposit	—	—	7,564,260.00	2,853,660.00
Less: other currency investments	14,149,464.78	4,149,464.78	3,000,000.00	—
Cash and cash equivalents	<u>157,726,606.62</u>	<u>112,111,009.79</u>	<u>186,103,027.24</u>	<u>119,007,678.59</u>

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2005

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

39. Other Cash Paid Relating to Operating Activities

Major items of other cash paid relating to operating activities amounting to RMB98,086,967.82 are as followings:

Items	Amount
Consultation fee	4,412,467.78
Entertainment fee	4,123,666.41
Research & development fee	2,543,412.72
Repair & maintenance	1,147,639.76
Retirement benefit	2,511,038.98
Land use fee	1,827,911.10
Labor insurance	1,167,695.76
Audit fee	1,998,500.00
Design fee	540,000.00
Warrant expense	3,163,546.01
Sundry expenses	2,496,985.01
Advertising expense	731,539.47
Listing management fee	1,144,037.17
Commission	2,399,250.40
Telephone expense	928,366.13
Traveling expense	5,059,829.87
Office expense	5,862,615.64
Installation fee	1,912,704.52
Transportation fee	1,254,291.95
Temporary borrowings	42,000,000.00
Total	87,225,498.68

40. Other cash received relating to investing activities amounting to RMB10,564,260.00 represents fixed-term deposit of currency asset in the beginning of the period and cash receipt of foreign currency asset.

41. Other cash paid relating to investing activities amounting to RMB14,149,464.78 represents guaranteed deposit of over three months in other currency asset in the beginning of the period.

42. Non-recurring Items

Items	Amount
Gain on disposal of fixed assets	(1,081,167.62)
Written back on various provision for diminution in previous years	—
Government grants	4,285,645.68
Impairment loss on deposits placed with securities company	636,306.05
Nonoperating gain	(1,219,596.07)
Negative impact from profits tax	(297,732.30)
Total	2,323,455.74

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2005

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

1. Accounts Receivable

Aged analysis	At 31st December, 2005			At 1st January, 2004		
	Amount	Proportion (%)	Provision on bad debt	Amount	Proportion (%)	Provision on bad debt
Within 1 year	35,191,194.61	53.36	1,226,728.48	25,964,326.09	49.35	928,848.01
1-2 years	9,986,367.03	15.14	4,838,633.52	11,515,109.46	21.88	4,861,529.72
2-3 years	5,484,579.25	8.32	5,484,579.25	2,344,893.36	4.46	2,294,893.36
Over 3 years	15,283,649.76	23.18	14,656,414.59	12,792,600.98	24.31	12,589,096.04
Total	65,945,790.65	100.00	26,206,355.84	52,616,929.89	100.00	20,674,367.13

Notes:

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

(2) Total amount of the 5 largest debtors is RMB10,841,576.30, constituting 16.44% of the total amount of accounts receivable.

2. Other Receivables

Aged analysis	At 31st December, 2005			At 1st January, 2004		
	Amount	Proportion (%)	Provision on bad debt	Amount	Proportion (%)	Provision on bad debt
Within 1 Year	26,440,698.78	98.44	517,484.94	6,168,777.61	88.54	233,141.38
1-2 Years	308,729.80	1.15	154,364.90	675,670.70	9.70	247,835.35
2-3 Years	9,396.75	0.04	9,396.75	27,032.50	0.39	27,032.50
Over 3 Years	99,961.60	0.37	99,961.60	95,782.30	1.37	95,782.30
Total	26,858,786.93	100.00	781,208.19	6,967,263.11	100.00	603,791.53

Note:

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

(2) Total amount of the 5 largest debtors is RMB20,917,500.00, which constitutes 77.88% of the total amount of other receivables.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2005

(6) NOTES TO THE FINANCIAL STATEMENTS OF THE COMPANY (Continued)

3. Long-term Equity Investment

(1) General of Investee Enterprises

Name of investee	Original cost	Investment proportion (%)	Investment period	Accounting method
Xian Ser Turbo Machinery Company Limited	22,500,000	45.00%	N/A	Equity method
Shanxi Hengtong Intelligent Machine Company Limited	23,838,606	65.34%	N/A	Equity method
Xian Jiaotong University Siyuan Intelligent Electric Apparatus Company Limited	27,310,000	78.03%	N/A	Equity method
Winko Machines Company Limited	19,320,000	95.50%	N/A	Equity method
TOS Kunming Machine Tool Company Limited	24,739,534	50.00%	20 Years	Equity method
Yunnan Cheng Jiang Copper Products Plant	2,000,000	40.00%	N/A	Cost method

(2) Changes in Long-term Equity Investment

Name of investee	At 1st January, 2005	Increase (decrease) in equity this year				At 31st December, 2005
		Investment cost	Adjusted equity	Dividend paid	Disposal	
Xian Ser Turbo Machinery Company Limited	24,672,549.81	–	9,894,043.38	–	–	34,566,593.19
Shanxi Hengtong Intelligent Machine Company Limited	17,159,852.64	–	(1,216,571.25)	–	–	15,943,281.39
Xian Jiaotong University Siyuan Intelligent Electric Apparatus Company Limited	27,379,480.31	–	(5,498,241.35)	–	–	21,881,238.96
Winko Machines Company Limited	17,412,867.00	930,000.00	(16,677,910.83)	–	–	1,664,956.17
TOS Kunming Machine Tool Company Limited	–	24,739,533.99	(920,719.24)	–	–	23,818,814.75
Yunnan Cheng Jiang Copper Products Plant	2,000,000.00	–	–	–	–	2,000,000.00
Less: Provision on impairment loss on long-term investment	2,000,000.00	–	–	–	–	2,000,000.00
Total	86,624,749.76	25,669,533.99	(14,419,399.29)	–	–	97,874,884.46

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2005

(6) NOTES TO THE FINANCIAL STATEMENTS OF THE COMPANY (Continued)

3. Long-term Investee Enterprises (Continued)

(3) Equity Investment Difference

Name of investee	Original cost	At 1st January, 2005	Addition this year	Amortization this year	At 31st December, 2005	Amortization period
Xian Ser Turbo Machinery Company Limited	7,296,277.00	5,107,393.84	–	729,627.72	4,377,766.12	10 Years
Shanxi Hengtong Intelligent Machine Company Limited	6,849,713.19	4,680,693.43	–	668,554.68	4,012,138.75	10 Years
Total	14,145,990.19	9,788,087.27	–	1,398,182.40	8,389,904.87	

Notes:

- (1) As Yunnan Cheng Jiang Copper Products Plant cease to be a going concern entity, the Company made the full amount of provision on impairment loss on long-term investment.
- (2) There is no significant difference between the accounting policies used by investee enterprises and that used by the Company. There is no significant restrictions to investment realization and investment gain inflow.

(4) Principal Operation Revenue and Cost

Items	2005 (Accumulated)		2004 (Accumulated)	
	Revenue	Cost	Revenue	Cost
Machine tool	403,009,411.32	305,316,858.06	262,930,144.36	193,064,905.56
Machine processing service	30,675,521.00	16,797,889.98	15,662,431.27	11,660,894.97
Others	5,149,613.02	2,251,790.25	5,520,904.99	768,486.53
Total	438,834,545.34	324,366,538.29	284,113,480.62	205,494,287.06

(5) Investment Income

Items	2005 (Accumulated)	2004 (Accumulated)
Income from investment in equity	(14,453,194.47)	2,829,103.98
Amortisation of equity investment difference	(1,398,182.40)	(1,398,182.40)
Provision for diminution in value of short-term investment	(680,411.67)	(37,545,954.48)
Income from short-term investment	–	808,092.39
Total	(16,531,788.54)	(35,306,940.51)

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2005

(7) RELATED PARTY RELATIONSHIP AND TRANSACTIONS

1. Details of Related Parties with Control Relationship

(1) Related Parties with Control Relationship

Name	Relationship with the company	Nature	Place of registration	Scope of business	Legal representative
Jiaotong Group	Substantial shareholders	State-owned	Xian City	Legally prohibited, not allowed to operate, should be approved, not allowed to operate before approval, not required to be legally approved, business which company is free to select, start the business activities.	Xi You Min
Shenyang Machine Tool (Group) Co. Ltd.	Potential substantial shareholders	Limited liability	Shenyang City	Production of metal-cutting machines, digital controlled software and machine accessories; General business trading and technology trading within PRC.	Chen Hui Ren
Xian Ser Turbo Machinery Company Limited (Xian Ser)	Subsidiary	Limited liability	Xian City	Design, develop and sales of turbo-machinery	Wang Shangjin
Shanxi Hengtong Intelligent Machine Company Limited (Shanxi Hengtong)	Subsidiary	Limited liability	Xian City	Develop and sales of manufacturing moulds, machinery, equipment, electronic products, software and hardware.	Lu Bingheng
Xian Jiaotong University Siyuan Intelligent Electric Apparatus Company Limited	Subsidiary	Limited liability	Xian City	Develop, manufacture and sales of electronic products, electric machinery and products of electronic power; Provide technology services.	Zhang Hanrong
Winko Machines Company Limited	Subsidiary	Limited liability	Kunming City	Develop, apply and integrate hardware and software; Retail, wholesale, purchase on behalf of others and consign electronic products, machinery and electronic machinery.	Zhang Hanrong

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2005

(7) RELATED PARTY RELATIONSHIP AND TRANSACTIONS *(Continued)*

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

(2) Registered Capital of Related Parties with Controlling Relationship

Name	At 1st January, 2005	Increase in this year	Decrease in this year	At 31st December, 2005
Jiaotong Group	30,000,000.00	—	—	30,000,000.00
Shenyang Machine Tool (Group) Co. Ltd.	712,840,000.00	—	—	712,840,000.00
Xian Ser Turbo Machinery Company Limited (Xian Ser)	4,560,692.00	45,439,308.00	—	50,000,000.00
Shanxi Hengtong Intelligent Machine Company Limited (Shanxi Hengtong)	27,960,000.00	—	—	27,960,000.00
Xian Jiaotong University Siyuan Intelligent Electric Apparatus Company Limited	35,000,000.00	—	—	35,000,000.00
Winko Machines Company Limited	20,230,000.00	—	—	20,230,000.00

(3) Shares and Equity held by Related Parties with Controlled Relationship

Name	At 1st January, 2004		Increase in this year	Decrease in this year	At 31st December, 2005	
	Amount	Proportion (%)			Amount	Proportion (%)
Jiaotong Group	71,052,146.00	29.00	—	—	71,052,146.00	29.00
Xian Ser Turbo Machinery Company Limited	2,052,312.00	45.00	20,447,688.00	—	22,500,000.00	45.00
Shanxi Hengtong Intelligent Machine Company Limited	18,270,000.00	65.34	—	—	18,270,000.00	65.34
Xian Jiaotong University Siyuan Intelligent Electric Apparatus Company Limited	27,310,000.00	78.03	—	—	27,310,000.00	78.03
Winko Machines Company Limited	18,390,000.00	90.91	930,000.00	—	19,320,000.00	95.50

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2005

(7) RELATED PARTY RELATIONSHIP AND TRANSACTIONS *(Continued)*

2. Related Parties with Non-controlling Relationship *(Continued)*

Name	Relationship with the Company
Kunji Group Company	Second-largest shareholders designated to manage equity
Yunnan Government	Promoter's shareholders
TOS Kunming Machine Tool Company Limited	Jointly controlled entity
Jiaoda HongFan High-Tech Company Limited	Subsidiary of substantial shareholder of the Company
The Pharmacy Group Co. Ltd of Xian Jiaotong University	Subsidiary of substantial shareholder of the Company

3. Related Party Transaction

(1) Sales of Goods

The Company sold goods at market value amounting to RMB355,810.26 and RMB699,145.30 to related party Kunji Group in 2005 and 2004 respectively.

The Company sold goods at market value amounting to RMB1,912,783.67 to related party TOS Kunming Machine Tool Company Limited in 2005.

A subsidiary sold goods at market value amounting to RMB1,296,500.00 to Xian Jiaotong University and its related parties.

(2) Provision and Receipt of Services

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

Items	2005 (Accumulated)	2004 (Accumulated)
Property management fee paid to Kunji Group	956,461.15	956,461.15
Staff medical service fee paid to Kunji Group	75,000.00	75,000.00
Social and education service fee paid to Kunji Group	162,500.00	325,000.00
Administrative fee for retired staff	75,384.00	75,384.00
Total	1,269,345.15	1,431,845.15

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2005

(7) RELATED PARTY RELATIONSHIP AND TRANSACTIONS *(Continued)*

3. Related Party Transaction *(Continued)*

(3) Purchase of Goods

The Company purchased goods of RMB6,600,000.00 from related party TOS Kunming Machine Tool Company Limited in 2005.

Shanxi Hengtong, a subsidiary of the Company, purchased accessories amounting to RMB1,748,408.40 and RMB2,168,361.69 in 2005 and 2004 respectively from related party Jiaoda HongFan High-Tech Company Limited.

(4) Leases

The 16th meeting of the 4th Board of Directors held on 18th April, 2004 approved that starting from 1st January, 2004 onwards, the Company would cease to implement "The Supplementary Premise Rental Agreement" and "The Supplementary Land Use Rental Agreement" signed on 10th February, 2002 between the Company and Kunji Group Company and would continue to use the respective agreements signed in 2001.

According to the resolution passed at the 26th meeting of the 4th Board of Directors, the Company signed with Kunji Group Company "The Rent Amendment Agreement of the Premises" and "The Rent Amendment Agreement of the Land Use Right", stating that Yunnan Government had authorized Kunji Group Company to adopt its rights and responsibilities mentioned in the original rental agreements. Besides, the annual rent of the premises and land use right between 2005 and 2007 are RMB850,080.00 and RMB1,320,000.00 respectively.

The asset mentioned in the above agreements involved the leaseback of part of the premises and land use right from the Yunnan Government after the capital restructuring in 2001.

In 2004, the Company leased back part of the premises and land use right at annual rent of RMB800,000.00 and RMB1,200,000.00 respectively with lease term of 20 years.

In 2005, the Company leased back part of the premises and land use right at annual rent of RMB850,080.00 and RMB1,320,000.00 respectively.

(5) Other Transactions

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

Transaction events	2005 (Accumulated)	2004 (Accumulated)
Rent, water and electricity fee paid to Jiaoda Group	1,363,110.00	1,372,459.33
Loan to Jiaoda Group	30,000,000.00	—
Interest paid to Jiaoda Group	101,141.67	—
Loan to Pharmacy Group of Xian Jiaoda University	10,100,000.00	—
Loan to TOS Kunming Machine Tool Co. Ltd.	2,000,000.00	—

- Transaction between the Company and Xian Jiaotong University (an investee of Jiaoda Industrial Group) are as follows:

Transaction events	2005 (Accumulated)	2004 (Accumulated)
Research fee paid to Xian Jiaotong University	1,150,000.00	1,508,000.00
Total	1,150,000.00	1,508,000.00

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2005

(7) RELATED PARTY RELATIONSHIP AND TRANSACTIONS *(Continued)*

3. Related Party Transaction *(Continued)*

(5) Other Transactions *(Continued)*

3. In 2005, the Company signed "The Agreement Concerning the Building Demolition" with Kunji Group Company and agreed the removal of 8 buildings on lease. It would pay RMB739,350.00 as the compensation to Kunji Group Company.
4. To execute the agreement with Xian Jiaotong University signed on 10th February, 2004, the Company offered a machine with value of RMB400,218.50 in 2005.
5. Xian Jiaotong University Siyuan Intelligent Electric Apparatus Company Limited, a subsidiary of the Company, signed "The Agreement Concerning the Development of the Northern Building No.2 and 3 in the University Surroundings" on 26th March, 2003. It would commit capital in these constructions and obtain the right of management for 23 years upon the completion of the project. It would be obligated to pay license fee for operating services in the university at the rate of RMB6.5 per square metre each month. In this year, the fee amounted to RMB1,228,500.00.
6. According to the premises and land use right agreements mentioned above, the amortization of prepaid lease amounted to RMB128,960.00.

4. Balances of Connected Transactions

Related Parties Name	Items	At the year end	At the beginning of the year	Nature
Jiaotong Group	Accounts receivable	322,775.00	—	Sales of goods
	Other Payables	1,352,276.00	1,440,000.00	Current account, License fee
	Accrued expenses	196,723.34	130,648.00	Accrued water and electricity fee
	Prepayments	100,000.00	100,000.00	Purchase
Xian Jiatong University Industrial (Group) Incorporation (other group companies)	Other receivables	645,200.00	345,200.00	Deposit and current account
Xian Jiaotong University	Other Payables	1,150,000.00	—	Research & development fee
Kunji Group Company	Other Payables	1,782,263.00	1,787,515.38	Accrued management fee
Kunming Kunji Group Sales Company Limited	Advances from customers	30,000.00	285,000.00	Sales of goods
Yunnan Government	Long-term payables due within one yearrent of fixed assets	342,168.90	342,168.90	Payable rent of fixed assets
	Long-term payables	3,069,175.70	3,282,384.80	Payable rent of fixed assets
Pharmacy Group of Xian Jiaoda University	Other receivables	10,000,000.00	—	Loan
Pharmacy Group of Xian Jiaoda University	Other payables	500,000.00	—	Current account
Jiaoda HongFan High-Tech Company Limited	Prepayments	(265,109.79)	248,735.53	Payables for purchase of goods
TOS Kunming Machine Tool Company Limited	Payables	251,000.00	—	Payables for purchase of goods

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2005

(8) CONTINGENT EVENTS

There are no contingent events required to be disclosed in this year.

(9) COMMITMENTS

Lease commitments:

For each of the three subsequent years after the balance sheet date and the years afterwards, the minimum lease payments are as follows:

Accounting year	Amount
2006	342,168.90
2007	342,168.90
2008	342,168.90
2009 onwards	4,448,195.70
Total	5,474,702.40

(10) POST BALANCE SHEET EVENT

Until the balance sheet date, the Company was involved in the following event in which no adjustment is required to be made:

On 3rd March, 2006, the Company received "The Letter about the Restructuring of China Fortune Securities" from the Restructuring Office of the China Fortune Securities ("China Fortune"). It stated that in according with the Document No.1 in 2006, "The Response to the Restructuring of China Fortune Securities", the receivership period of China Fortune ended on 6th January, 2006. Capital Airport Group Company, as the major debtor, officially initiated the restructuring of China Fortune and it should last for six month in maximum. The restructuring may have an effect to the short-term investment of RMB50,000,000 the Company entrusted to China Fortune.

(11) DEBT RESTRUCTURING EVENTS

The Company has no debt restructuring events in this year.

(12) OTHER SIGNIFICANT EVENTS

1. Land Appreciation Tax (LAT)

During December 2001, the Company implemented capital restructuring and sold several buildings and land use right to Yunnan Provincial Government in the form of leaseback. According to Tax Document No. 1 in 2002 of the Department of Finance of Yunnan Province, "Concerning the Tax Payable Opinion about Capital Restructuring between Jiaoda Kunji High-Tech Company Limited and Xian Jiaotong University Industrial (Group) Incorporation", Paper 3 Document No. 9 in 2002 of the Local Taxation Bureau of Yunnan Province, "Opinion concerning Land Appreciation Tax issue resulted from Capital Restructuring between Jiaoda Kunji High-Tech Company Limited and Xian Jiaotong University Industrial (Group) Incorporation" and Yunnan Provincial Government, the Land Appreciation Tax (LAT) payable of RMB10,984,000 was temporarily waived.

In March 2005, Tax Policy Department, Ministry of Finance issued the Document No. 6 in 2005, "In Response to the Land Appreciation Tax Policy regarding Capital Restructuring between Jiaoda Kunji High-Tech Company Limited and Xian Jiaotong University Industrial (Group) Incorporation", referring that the building transfer would result in Land Appreciation Tax payable.

According to the above situation, the provision for Land Appreciation Tax for the year was RMB10,984,000, after the reversal of the deferred income of RMB9,714,394.95 at the beginning of 2005, the remaining balance of RMB1,269,605.05 was considered as non-operating expenses.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2005

(12) OTHER SIGNIFICANT EVENTS *(Continued)*

2. Difference between the PRC GAAP and HK GAAP

These financial statements are prepared in accordance with the PRC GAAP, which are different from those prepared in accordance with HK GAAP.

The consolidated net profit in year 2005 and the consolidated net asset as at 31st December, 2005 are RMB18,321,052.33 and RMB531,994,238.15. According to the HK GAAP, the major adjustments to the consolidated net profit and the consolidated net asset are as follows:

Items	Net profit	Net assets
In accordance to PRC GAAP	18,321,052.33	531,994,238.15
Less: Taxation of land use right leaseback transaction	9,714,394.95	—
Add: Gain on share profit from subsidiaries	(272,552.00)	(8,216,347.15)
Add: Donations	33,795.18	—
Add: Amortisation on deferred gain	201,182.00	—
Add: Amortisation on goodwill	2,243,101.00	2,243,101.00
Add: Profit tax recoverable by subsidiaries	189,022.00	338,949.00
Add: Capital restructuring income	—	(3,218,914.00)
In accordance to the HK GAAP	11,001,205.56	523,141,027.00

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

3. The Net Asset Profit Ratio and Earning Per Share for 2004 and 2005 are as followings:

Items	For the year ended 31st December, 2005				For the year ended 31st December, 2004			
	Net asset profit ratio (%)		Earning per share (RMB)		Net asset profit ratio (%)		Earning per share (RMB)	
	Dilutive	Weighted average	Dilutive	Weighted average	Dilutive	Weighted average	Dilutive	Weighted average
Principal								
operating income	32.95%	33.86%	0.7154	0.7154	25.78%	25.35%	0.5312	0.5312
Operating profit	9.74%	10.02%	0.2116	0.2116	5.30%	5.21%	0.1091	0.1091
Net profit	3.44%	3.54%	0.0748	0.0748	(3.38)%	(3.33)%	(0.0697)	(0.0697)
Net profit after deducting non-recurring items	3.01%	3.09%	0.0653	0.0653	1.50%	1.48%	0.0309	0.0309



TO THE SHAREHOLDERS OF
JIAODA KUNJI HIGH-TECH COMPANY LIMITED
交大昆機科技股份有限公司

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

We have audited the consolidated financial statements of Jiaoda Kunji High-Tech Company Limited (the Company) and its subsidiaries (the Group) from pages 90 to 136 which have been prepared in accordance with accounting principles generally accepted in Hong Kong.

RESPECTIVE RESPONSIBILITIES OF DIRECTORS AND AUDITORS

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

It is our responsibility to form an independent opinion, based on our audit, on those financial statements and to report our opinion solely to you, as a body, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

BASIS OF OPINION

We conducted our audit in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the consolidated financial statements. It also includes an assessment of the significant estimates and judgments made by the directors in the preparation of the consolidated financial statements, and of whether the accounting policies are appropriate to the circumstances of the Group, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance as to whether the consolidated financial statements are free from material misstatement. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the consolidated financial statements. We believe that our audit provides a reasonable basis for our opinion.

OPINION

In our opinion the consolidated financial statements give a true and fair view of the state of affairs of the Group as at 31st December, 2005 and of the profit and cash flows of the Group for the year then ended and have been properly prepared in accordance with the disclosure requirements of the Hong Kong Companies Ordinance.

DELOITTE TOUCHE TOHMATSU
Certified Public Accountants
Hong Kong
10th April, 2006

CONSOLIDATED INCOME STATEMENT

FOR THE YEAR ENDED 31ST DECEMBER, 2005

	NOTES	2005 RMB'000	2004 RMB'000
Revenue	6	672,643	469,436
Cost of sales		(497,353)	(339,298)
Gross profit		175,290	130,138
Other income	8	6,272	11,329
Administrative expenses		(77,331)	(62,951)
Distribution costs		(32,897)	(31,004)
Finance costs	9	(6,139)	(8,966)
Other expenses		(32,560)	(7,115)
Impairment loss on available-for-sale investments		(680)	–
Impairment loss on other investments		–	(41,796)
Share of results of jointly controlled entity	21	(921)	–
Profit (loss) before tax	10	31,034	(10,365)
Income tax expense	11	(9,752)	(4,076)
Profit (loss) for the year		21,282	(14,441)
Attributable to:			
Equity holders of the parent		11,001	(17,586)
Minority interests		10,281	3,145
		21,282	(14,441)
Earnings (loss) per share	15	RMB4.5 cents	RMB(7.2 cents)

CONSOLIDATED BALANCE SHEET

AT 31ST DECEMBER, 2005

	NOTES	2005 RMB'000	2004 RMB'000 (restated)
Non-current assets			
Property, plant and equipment	16	376,819	348,776
Prepaid lease payments	17	25,289	26,246
Goodwill	18	15,965	17,284
Intangible assets	19	18,802	27,424
Deferred costs	20	3,551	3,645
Interest in a jointly controlled entity	21	14,949	—
		455,375	423,375
Current assets			
Inventories	22	274,503	323,471
Trade receivables	23	104,935	96,275
Prepaid lease payments	17	603	320
Other receivables	24	45,119	73,799
Amount due from a related company	25	9,600	—
Available-for-sale investments	26	8,524	—
Other investments	27	—	9,204
Taxation recoverable		62	193
Pledged bank deposits	28	2,109	7,711
Bank balances and cash	29	169,767	188,957
		615,222	699,930
Current liabilities			
Trade payables	30	98,327	63,507
Advances from customers	31	196,940	300,934
Other payables	32	69,580	36,279
Deferred income	33	4,007	1,350
Amounts due to related companies	34	2,288	3,397
Taxation payable		3,344	4,601
Obligations under finance leases – due within one year	35	235	235
Bank borrowings – due within one year	36	60,000	137,091
		434,721	547,394
Net current assets		180,501	152,536
		635,876	575,911

CONSOLIDATED BALANCE SHEET

AT 31ST DECEMBER, 2005

	NOTES	2005 RMB'000	2004 RMB'000 (restated)
Capital and reserves			
Share capital	37	245,007	245,007
Reserves		278,134	267,133
Equity attributable to equity holders of the parent		523,141	512,140
Minority interests		59,098	49,698
Total equity		582,239	561,838
Non-current liabilities			
Obligations under finance leases – due after one year	35	3,218	3,453
Bank borrowings – due after one year	36	40,000	–
Deferred gain	38	3,219	3,420
Other long-term loan	39	7,200	7,200
		53,637	14,073
		635,876	575,911

The financial statements on pages 90 to 136 were approved and authorised for issue by the Board of Directors on 10th April, 2006 and are signed on its behalf by:

Mr. Zhang Hanrong
DIRECTOR

Mr. Cheng Yunchuan
DIRECTOR

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

FOR THE YEAR ENDED 31ST DECEMBER, 2005

	Attributable to equity holders of the parent						Total	Minority interests	Total
	Share capital	Share premium	Capital reserve	Statutory surplus reserve	Statutory public welfare fund	Accumulated losses			
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
At 1st January, 2004	245,007	293,745	10,225	8,717	8,561	(36,529)	529,726	23,391	553,117
Loss for the year and total recognised income and expenses for the year	-	-	-	-	-	(17,586)	(17,586)	3,145	(14,441)
Capital contribution from minority shareholders	-	-	-	-	-	-	-	24,203	24,203
Dividend paid to minority shareholders	-	-	-	-	-	-	-	(1,041)	(1,041)
Transfer	-	-	-	575	-	(575)	-	-	-
At 31st December, 2004	245,007	293,745	10,225	9,292	8,561	(54,690)	512,140	49,698	561,838
Profit for the year and total recognised income for the year	-	-	-	-	-	11,001	11,001	10,281	21,282
Acquisition of additional interest in a subsidiary	-	-	-	-	-	-	-	(881)	(881)
At 31st December, 2005	245,007	293,745	10,225	9,292	8,561	(43,689)	523,141	59,098	582,239

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

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

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

CONSOLIDATED CASH FLOW STATEMENT

FOR THE YEAR ENDED 31ST DECEMBER, 2005

	2005 RMB'000	2004 RMB'000
OPERATING ACTIVITIES		
Profit (loss) before tax	31,034	(10,365)
Adjustments for:		
Interest income	(1,755)	(1,269)
Investment income on other investments	—	(4,890)
Share of results of jointly controlled entity	921	—
Release of prepaid lease payment	674	—
Interest paid	6,139	8,966
Amortisation of deferred gain	(201)	(201)
Depreciation and amortisation of property, plant and equipment	26,910	25,974
Amortisation of intangible assets	4,047	4,130
Amortisation of goodwill	—	2,260
Amortisation of prepaid rental	94	93
Impairment loss of property, plant and equipment	5,164	—
Impairment loss of goodwill	1,369	—
Impairment loss of intangible assets	4,575	—
Impairment loss on available-for-sale investments	680	—
Impairment loss on other investments	—	41,796
Net loss on disposal of property, plant and equipment	1,191	251
Gain on disposal of other investments	—	(168)
Allowance for bad and doubtful debts	11,078	13,982
Allowance for inventories written back	(1,297)	(4,031)
Operating cash flows before movements in working capital	90,623	76,528
Decrease (increase) in inventories	46,184	(72,434)
Increase in trade receivables	(21,066)	(2,832)
Decrease (increase) in other receivables	30,008	(13,899)
Decrease in amount due from a related company	—	3
Increase in trade payables	34,820	14,036
(Decrease) increase in advances from customers	(103,994)	107,910
Increase in other payables	33,849	5,300
Increase in deferred income	2,657	1,350
(Decrease) increase in amounts due to related companies	(6)	1,766
Cash generated from operations	113,075	117,728
Income taxes paid	(10,878)	(2,319)
NET CASH FROM OPERATING ACTIVITIES	102,197	115,409

CONSOLIDATED CASH FLOW STATEMENT

FOR THE YEAR ENDED 31ST DECEMBER, 2005

	2005 <i>RMB'000</i>	2004 <i>RMB'000</i>
INVESTING ACTIVITIES		
Purchase of property, plant and equipment	(64,800)	(99,420)
Investment in jointly controlled entity	(9,848)	–
Advance to a related company	(9,600)	–
Acquisition of additional interest in a subsidiary	(931)	–
Decrease in pledged bank deposits	5,602	18,931
Interest received	1,755	1,269
Proceeds from disposal of property, plant and equipment	1,003	430
Purchase of other investments	–	(136,000)
Proceeds from disposal of other investments	–	95,168
Investment income on other investments	–	4,250
NET CASH USED IN INVESTING ACTIVITIES	(76,819)	(115,372)
FINANCING ACTIVITIES		
Repayment of bank loans	(77,091)	(143,909)
Interest paid	(6,139)	(8,966)
Amounts due to related companies	(1,103)	–
Repayment of obligations under finance leases	(235)	(215)
New bank loans raised	40,000	162,000
Dividend paid to minority shareholders	–	(1,041)
Repayment of other long-term loans	–	(1,500)
Capital contributions by minority shareholders	–	24,203
NET CASH (USED IN) FROM FINANCING ACTIVITIES	(44,568)	30,572
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(19,190)	30,609
CASH AND CASH EQUIVALENTS AT BEGINNING OF THE YEAR	188,957	158,348
CASH AND CASH EQUIVALENTS AT END OF THE YEAR, represented by bank balances and cash	169,767	188,957

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2005

1. GENERAL

The Company is a sino-foreign joint stock limited company established in the People's Republic of China (the "PRC") and its shares are listed on The Stock Exchange of Hong Kong Limited and the Shanghai Securities Exchange. The immediate holding company is Jiaotong Group. The addresses of the registered office and principal place of business of the Company are disclosed in the Company Information of the annual report.

The financial statements are presented in Renminbi ("RMB") which is the same as the functional currency of the Company.

The Company acts as an investment holding company and it is also engaged in the design, development, manufacture and sale of machine tools, precision measuring equipment and precision transducers. The principal activities of its subsidiaries are set out in Note 46.

2. APPLICATION OF HONG KONG FINANCIAL REPORTING STANDARDS/ CHANGES IN ACCOUNTING POLICIES

In the current year, the Group has applied, for the first time, a number of new Hong Kong Financial Reporting Standards ("HKFRSs"), Hong Kong Accounting Standards ("HKASs") and Interpretations (hereinafter collectively referred to as "new HKFRSs") issued by the Hong Kong Institute of Certified Public Accountants (the "HKICPA") that are effective for accounting periods beginning on or after 1st January, 2005. The application of the new HKFRSs has resulted in a change in the presentation of the consolidated income statement, consolidated balance sheet and consolidated statement of changes in equity. In particular, the presentation of minority interests have been changed. The changes in presentation have been applied retrospectively. The adoption of the new HKFRSs has resulted in changes to the Group's accounting policies in the following areas that have an effect on how the results for the current and prior accounting years are prepared and presented:

Business Combinations

In the current year, the Group has applied HKFRS 3 *Business Combinations* which is effective for business combinations for which the agreement date is on or after 1st January, 2005 and for goodwill previously recognised and brought forward as at 1st January, 2005. The principal effects of the application of the transitional provisions of HKFRS 3 to the Group are summarised below:

Goodwill

With respect to goodwill previously capitalised on the balance sheet, the Group on 1st January, 2005 eliminated the carrying amount of the related accumulated amortisation of RMB7,146,000 with a corresponding decrease in the cost of goodwill (see Note 18). The Group has discontinued amortising such goodwill from 1st January, 2005 onwards and such goodwill will be tested for impairment at least annually. Goodwill arising on acquisitions after 1st January, 2005 is measured at cost less accumulated impairment losses (if any) after initial recognition. As a result of this change in accounting policy, no amortisation of goodwill has been charged in the current year. Comparative figures for 2004 have not been restated (see Note 2A for the financial impact).

For the purpose of impairment testing, goodwill is allocated to each of the Group's cash-generating units and there is no indication that the units may be impaired.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2005

2. APPLICATION OF HONG KONG FINANCIAL REPORTING STANDARDS/ CHANGES IN ACCOUNTING POLICIES *(Continued)*

Financial Instruments

In the current year, the Group has applied HKAS 32 *Financial Instruments: Disclosure and Presentation* and HKAS 39 *Financial Instruments: Recognition and Measurement*. HKAS 32 requires retrospective application. HKAS 39, which is effective for annual periods beginning on or after 1st January, 2005, generally does not permit the recognition, derecognition or measurement of financial assets and liabilities on a retrospective basis. HKAS 32 has no impact on the financial statements. The principal effects resulting from the implementation of HKAS 39 are summarised below:

Classification and measurement of financial assets and financial liabilities

The Group has applied the relevant transitional provisions in HKAS 39 with respect to the classification and measurement of financial assets and financial liabilities that are within the scope of HKAS 39.

At 31st December, 2004, the Group classified and measured its equity securities in accordance with the benchmark treatment of Statement of Standard Accounting Practice 24 (SSAP 24). Under SSAP 24, investments in equity securities are classified as "investment securities", or "other investments" as appropriate. "Investment securities" are carried at cost less impairment losses (if any) while "other investments" are measured at fair value, with unrealised gains or losses included in profit or loss. From 1st January, 2005 onwards, the Group has classified and measured its equity securities in accordance with HKAS 39. Financial assets are classified as "financial assets at fair value through profit or loss", "available-for-sale financial assets" or "loans and receivables". "Financial assets at fair value through profit or loss" and "available-for-sale financial assets" are carried at fair value, with changes in fair values recognised in profit or loss and equity respectively. "Loans and receivables" are measured at amortised cost using the effective interest method after initial recognition.

On 1st January, 2005, the Group classified and measured its equity securities in accordance with the transitional provision of HKAS 39. Other investments amounting to RMB9,204,000 has been reclassified as available-for-sale investments on 1st January, 2005 (see Note 2A for the financial impact).

Financial assets and financial liabilities other than debt and equity securities

From 1st January, 2005 onwards, the Group has classified and measured its financial assets and financial liabilities other than debt and equity securities (which were previously outside the scope of SSAP 24) in accordance with the requirements of HKAS 39. Financial assets under HKAS 39 are classified as "financial assets at fair value through profit or loss", "available-for-sale financial assets", "loans and receivables" or "held-to-maturity financial assets". Financial liabilities are generally classified as "financial liabilities at fair value through profit or loss" or "other financial liabilities". Financial liabilities at fair value through profit or loss are measured at fair value, with changes in fair value being recognised in profit or loss directly. Other financial liabilities are carried at amortised cost using the effective interest method after initial recognition.

Prior to the application of HKAS 39, an interest-free non-current other long-term loans were stated at the nominal amount. HKAS 39 requires all financial assets and financial liabilities to be measured at fair value on initial recognition. Such interest free other loans are measured at amortised cost determined using the effective interest method at subsequent balance sheet dates.

The Group has applied the relevant transitional in HKAS 39. However, there has been no material effect on how the results for the current accounting period are prepared and presented.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2005

2. APPLICATION OF HONG KONG FINANCIAL REPORTING STANDARDS/ CHANGES IN ACCOUNTING POLICIES *(Continued)*

Owner-occupied Leasehold Interest in Land

In previous years, owner-occupied leasehold land and buildings were included in property, plant and equipment and measured using the cost model. In the current year, the Group has applied HKAS 17 *Leases*. Under HKAS 17, the land and buildings elements of a lease of land and buildings are considered separately for the purposes of lease classification, unless the lease payments cannot be allocated reliably between the land and buildings elements, in which case, the entire lease is generally treated as a finance lease. To the extent that the allocation of the lease payments between the land and buildings elements can be made reliably, the leasehold interests in land are reclassified to prepaid lease payments under operating leases, which are carried at cost and amortised over the lease term on a straight-line basis. This change in accounting policy has been applied retrospectively (see Note 2A for the financial impact).

2A. SUMMARY OF THE EFFECTS OF THE CHANGES IN ACCOUNTING POLICIES

The effects of the changes in the accounting policies described above on the results for the current and prior year are as follows:

	2005 RMB'000	2004 RMB'000
Non-amortisation of goodwill included in other expenses and increase in profit for the year	2,260	—

The cumulative effects of the application of the new HKFRSs on 31st December, 2004 and 1st January, 2005 are summarised below:

	As at 31st December, 2004 (originally stated) RMB'000	Retrospective adjustment RMB'000	As at 31st December, 2004 (restated) RMB'000	Prospective adjustments RMB'000	As at 1st January, 2005 (restated) RMB'000
Balance sheet items					
On adoption of HKAS 17					
Property, plant and equipment	375,342	(26,566)	348,776	—	348,776
Prepaid lease payments	—	26,566	26,566	—	26,566
On adoption of HKAS 39					
Available-for-sale investments	—	—	—	9,204	9,204
Other investments	9,204	—	9,204	(9,204)	—
On adoption of HKAS 1					
Minority interests	—	49,698	49,698	—	49,698
Total effects on assets and liabilities	384,546	49,698	434,244	—	434,244
Minority interests	49,698	(49,698)	—	—	—

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2005

2A. SUMMARY OF THE EFFECTS OF THE CHANGES IN ACCOUNTING POLICIES

(Continued)

As a result of the application of the new HKAS 1, minority interests of RMB49,698,000 at 1st January, 2004 was included as part of the total equity.

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

HKAS 1 (Amendment)	Capital disclosures ¹
HKAS 19 (Amendment)	Actuarial gains and losses, group plans and disclosures ²
HKAS 21 (Amendment)	Net investment in a foreign operation ²
HKAS 39 (Amendment)	Cash flow hedge accounting of forecast intragroup transactions ²
HKAS 39 (Amendment)	The fair value option ²
HKAS 39 & HKFRS 4 (Amendments)	Financial guarantee contracts ²
HKFRS 6	Exploration for and evaluation of mineral resources ²
HKFRS 7	Financial instruments: Disclosures ¹
HK(IFRIC) – INT 4	Determining whether an arrangement contains a lease ²
HK(IFRIC) – INT 5	Rights to interests arising from decommissioning, restoration and environmental rehabilitation funds ²
HK(IFRIC) – INT 6	Liabilities arising from participating in a specific market – waste electrical and electronic equipment ³
HK(IFRIC) – INT 7	Applying the restatement approach under HKAS 29 Financial Reporting in Hyperinflationary Economies ⁴

¹ Effective for annual periods beginning on or after 1st January, 2007.

² Effective for annual periods beginning on or after 1st January, 2006.

³ Effective for annual periods beginning on or after 1st December, 2005.

⁴ Effective for annual periods beginning on or after 1st March, 2006.

The Group is in the process of assessing the impact of these new standards, amendments and interpretations in the period of initial recognition. The Group is not yet in a position to state whether the adoption of them would have a significant impact on the results of its operations and its financial position.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2005

3. SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements have been prepared under the historical cost basis except for the revaluation of available-for-sale investments.

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

Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Company and its subsidiaries.

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

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

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

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

Goodwill

Goodwill arising on acquisitions prior to 1st January, 2005

Goodwill arising on an acquisition of a subsidiary for which the agreement date is before 1st January, 2005 represents the excess of the cost of acquisition over the Group's interest in the fair value of the identifiable assets and liabilities of the relevant subsidiary at the date of acquisition.

For previously capitalised goodwill, the Group has discontinued amortisation from 1st January, 2005 onwards, and such goodwill is tested for impairment annually, and whenever there is an indication that the cash generating unit to which the goodwill relates may be impaired (see the accounting policy below).

Goodwill arising on acquisitions on or after 1st January, 2005

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

Capitalised goodwill arising on an acquisition of a subsidiary is presented separately in the balance sheet.

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

On subsequent disposal of a subsidiary, the attributable amount of goodwill capitalised is included in the determination of the amount of profit or loss on disposal.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2005

3. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

Joint ventures

Jointly controlled entities

Joint venture arrangements that involve the establishment of a separate entity in which venturers have joint control over the economic activity of the entity are referred to as jointly controlled entities.

The results and assets and liabilities of jointly controlled entities are incorporated in the consolidated financial statements using the equity method of accounting. Under the equity method, investments in jointly controlled entities are carried in the consolidated balance sheet at cost as adjusted for post-acquisition changes in the Group's share of the profit or loss and of changes in equity of the jointly controlled entities, less any identified impairment loss. When the Group's share of losses of a jointly controlled entity equals or exceeds its interest in that jointly controlled entity, the Group discontinues recognising its share of further losses. An additional share of losses is provided for and a liability is recognised only to the extent that the Group has incurred legal or constructive obligations or made payments on behalf of that jointly controlled entity.

When a group entity transacts with a jointly controlled entity of the Group, unrealised profits or losses are eliminated to the extent of the Group's interest in the jointly controlled entity, except to the extent that unrealised losses provide evidence of an impairment of the asset transferred, in which case, the full amount of losses is recognised.

Revenue recognition

Revenue is measured at the fair value of the consideration received or receivable for goods and services provided in the normal course of businesses, net of discounts and related sales taxes.

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

Service income is recognised when services are provided.

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

Property, plant and equipment

Property, plant and equipment, other than construction-in-progress, are stated at cost less subsequent accumulated depreciation and accumulated impairment losses.

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

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

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

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

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2005

3. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

Construction-in-progress

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

When the leasehold land and buildings are in the course of development for production, rental or for administrative purposes, the leasehold land component is classified as a prepaid lease payment and amortised over a straight-line basis over the lease term. During the construction period, the amortisation charge provided for the leasehold land is included as part of costs of buildings under construction. Buildings under construction are carried at cost, less any identified impairment losses. Depreciation of buildings commences when they are available for use.

Intangible assets

On initial recognition, intangible assets acquired separately are recognised at cost. After initial recognition, intangible assets with finite useful lives are carried at costs less accumulated amortisation and any accumulated impairment losses. Amortisation for intangible assets with finite useful lives is provided on a straight-line basis over their estimated useful lives.

Impairment losses (other than goodwill)

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

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

Inventories

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

Borrowing costs

Borrowing costs directly attributable to the acquisition, construction or production of qualifying assets, are capitalised as part of the cost of those assets. Capitalisation of such borrowing costs ceases when the assets are substantially ready for their intended use or sale.

All other borrowing costs are recognised as an expense in the period in which they are incurred.

Government grants

Government grants are recognised as income over the periods necessary to match them with the related costs. Grants related to depreciable assets are presented as deferred income and are released to income over the useful lives of the assets. Grants related to expense items are recognised in the same period as those expenses are charged in the income statement and are reported separately as other income.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2005

3. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

Leasing

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

The Group as lessor

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

The Group as lessee

Rentals payable under operating leases are charged to profit or loss on a straight-line basis over the term of the relevant lease. Benefits received and receivable as an incentive to enter into an operating lease are recognised as a reduction of rental expense over the lease term on a straight-line basis.

Taxation

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

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

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

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

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

Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset is realised based on tax rates that have been enacted or substantively enacted by the balance sheet date. Deferred tax is charged or credited to profit or loss, except when it relates to items is charged or credited directly to equity, in which case the deferred tax is also dealt with in equity.

Research and development expenditures

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

An internally-generated intangible asset arising from development expenditure is recognised only if it is anticipated that the development costs incurred on a clearly defined project will be recovered through future commercial activity. The resultant asset is amortised on a straight-line basis over its estimated useful life, and carried at cost less subsequent accumulated amortisation and any accumulated impairment losses.

Where no internally-generated intangible asset can be recognised, development expenditure is charged to profit or loss in the period in which it is incurred.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2005

3. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

Retirement scheme cost

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

Foreign currencies

In preparing the financial statements of each individual group entity, transactions in currencies other than the functional currency of that entity (foreign currencies) are recorded in its functional currency (i.e. the currency of the primary economic environment in which the entity operates) at the rates of exchanges prevailing on the dates of the transactions. At each balance sheet date, monetary items denominated in foreign currencies are retranslated at the rates prevailing on the balance sheet date. Non-monetary items carried at fair value that are denominated in foreign currencies are retranslated at the rates prevailing on the date when the fair value was determined. Non-monetary items that are measured in terms of historical cost in a foreign currency are not retranslated.

Exchange differences arising on the settlement of monetary items, and on the translation of monetary items, are recognised in profit or loss in the period in which they arise. Exchange differences arising on the retranslation of non-monetary items carried at fair value are included in profit or loss for the period except for differences arising on the retranslation of non-monetary items in respect of which gains and losses are recognised directly in equity, in which cases, the exchange differences are also recognised directly in equity.

Financial instruments

Financial assets and financial liabilities are recognised on the balance sheet when a group entity becomes a party to the contractual provisions of the instrument. Financial assets and financial liabilities are initially measured at fair value. Transaction costs that are directly attributable to the acquisition or issue of financial assets and financial liabilities are added to or deducted from the fair value of the financial assets or financial liabilities, as appropriate, on initial recognition.

Financial assets

The Group's financial assets are classified into one of the two categories, including loans and receivables and available-for-sale financial assets. All regular way purchases or sales of financial assets are recognised and derecognised on a trade date basis. Regular way purchases or sales are purchases or sales of financial assets that require delivery of assets within the timeframe established by regulation or convention in the marketplace. The accounting policies adopted in respect of each category of financial assets are set out below.

Loans and receivables

Loans and receivables (including trade receivables, other receivables, amount due from a related company and bank deposits) are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. At each balance sheet date subsequent to initial recognition, trade and other receivables are carried at amortised cost using the effective interest method, less any identified impairment losses. An impairment loss is recognised in profit or loss when there is objective evidence that the asset is impaired, and is measured as the difference between the asset's carrying amount and the present value of the estimated future cash flows discounted at the original effective interest rate. Impairment losses are reversed in subsequent periods when an increase in the asset's recoverable amount can be related objectively to an event occurring after the impairment was recognised, subject to a restriction that the carrying amount of the asset at the date the impairment is reversed does not exceed what the amortised cost would have been had the impairment not been recognised.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2005

3. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

Financial instruments *(Continued)*

Available-for-sale financial assets

Available-for-sale financial assets are non-derivatives that are designated. At each balance sheet date subsequent to initial recognition, available-for-sale financial assets are measured at fair value. Changes in fair value are recognised in equity, until the financial asset is disposed of or is determined to be impaired, at which time, the cumulative gain or loss previously recognised in equity is removed from equity and recognised in profit or loss. Any impairment losses on available-for-sale financial assets are recognised in profit or loss. Impairment losses on available-for-sale equity investments will not reverse in subsequent periods.

An impairment loss is recognised in profit or loss when there is objective evidence that the asset is impaired. The amount of the impairment loss is measured as the difference between the carrying amount of the asset and the present value of the estimated future cash flows discounted at the current market rate of return for a similar financial asset. Such impairment losses will not reverse in subsequent periods.

Financial liabilities and equity

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

An equity instrument is any contract that evidences a residual interest in the assets of the group after deducting all of its liabilities. The Group's financial liabilities are generally other financial liabilities. The accounting policies adopted in respect of financial liabilities and equity instruments are set out below.

Other financial liabilities

Other financial liabilities including bank and other borrowings, trade and other payables, amounts due to related companies and obligations under finance leases, are subsequently measured at amortised cost, using the effective interest rate method.

Equity instruments

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

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2005

4. CRITICAL ACCOUNTING JUDGMENTS AND KEY SOURCES OF ESTIMATION UNCERTAINTY

In the process of applying the entity's accounting policies which are described in Note 3, management has made the following estimates that have significant effect on the amounts recognised in the consolidated financial statements. The key assumptions concerning the future, and other key sources of estimation uncertainty at the balance sheet date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year, are also discussed below.

Allowance for inventories

The management of the Group reviews an aged analysis at each balance sheet date and makes allowances for obsolete and slow-moving inventory items that are no longer suitable for use in production. The management estimates the net realisable value for such finished goods and work-in progress based primarily on the latest invoice prices and current market conditions. The Group carries out an inventory review on a product-by-product basis at each balance sheet date and makes allowances for obsolete items.

Allowance for bad and doubtful debts

The policy for allowance for bad and doubtful debts of the Group is based on the evaluation of collectability and aged analysis of accounts and on management's judgment. A considerable amount of judgment is required in assessing the ultimate realisation of these receivables, including the current creditworthiness and the past collection history of each customer. If the financial conditions of customers of the Group were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required.

Estimated impairment of goodwill

Determining whether goodwill is impaired requires an estimation of the value in use of the cash-generating units to which goodwill has been allocated. The value in use calculation requires the Group to estimate the future cash flows expected to arise from the cash-generating unit and a suitable discount rate in order to calculate the present value. As at 31st December, 2005, the carrying amount of goodwill is RMB15,965,000. Details of the recoverable amount calculation are disclosed in Note 18.

5. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES

The Group's major financial instruments include borrowings, trade receivables and trade payables. Details of these financial instruments are disclosed in respective notes. The risks associated with these financial instruments and the policies on how to mitigate these risks are set out below. The management manages and monitors these exposures to ensure appropriate measures are implemented on a timely and effective manner.

Interest rate risk

The Group's fair value interest rate risk relates to fixed-rate borrowings (see Note 36 for details of these borrowings).

Besides, the Group is exposed to interest rate risk through the impact of rate changes on interest bearing bank borrowings and obligations under finance leases. The interest rate and terms of repayment of the obligations under finance leases and the bank borrowings of the Group are disclosed in Notes 35 and 36 respectively. In relation to these fixed-rate borrowings, the Group aims at keeping borrowings at borrowings at variable rates with consistent negotiations with the banks in the future.

Credit risk

The Group's maximum exposure to credit risk in the event of the counterparties, failure to perform their obligations as at 31st December, 2005 is the carrying amount of trade and bills receivables as stated in the consolidated balance sheet. In order to minimise the credit risk, the management of the Group has delegated a team responsible for determination of credit limits, credit approvals and other monitoring procedures to ensure that follow-up action is taken to recover overdue debts. In addition, the Group reviews the recoverable amount of each individual trade debt at each balance sheet date to ensure that adequate impairment losses are made for irrecoverable amounts. In this regard, the directors of the Company consider that the Group's credit risk is significantly reduced.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2005

6. REVENUE

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

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

	2005 RMB'000	2004 RMB'000
Sales of goods	637,886	447,428
Services rendered	34,757	22,008
	672,643	469,436

7. SEGMENT INFORMATION

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

Business segments

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

2005

	Boring machines RMB'000	Computerised embroidery machines RMB'000	Intelligent electrical appliances RMB'000	Turbo machines RMB'000	Laser prototyping machines RMB'000	Eliminations RMB'000	Consolidated RMB'000
REVENUE	438,835	10,112	10,372	285,147	12,796	(84,619)	672,643
Segment result	33,753	(10,293)	(7,492)	32,216	(2,021)	(7,105)	39,058
Other operating income							6,272
Finance costs							(6,139)
Impairment loss on available-for-sale investments							(680)
Unallocated corporate expenses							(6,556)
Share result of jointly controlled entity							(921)
Profit before tax							31,034
Income tax expense							(9,752)
Profit for the year							21,282

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2005

7. SEGMENT INFORMATION *(Continued)*

Business segments *(Continued)*

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

2005

	Boring machines RMB'000	Computerised embroidery machines RMB'000	Intelligent electrical appliances RMB'000	Turbo machines RMB'000	Laser prototyping machines RMB'000	Eliminations RMB'000	Consolidated RMB'000
ASSETS							
Segment assets	589,037	22,797	44,564	246,087	26,416	(38,766)	890,135
Unallocated corporate assets							180,462
Consolidated total assets							<u>1,070,597</u>
LIABILITIES							
Segment liabilities	(182,933)	(23,432)	(10,200)	(186,913)	(3,973)	33,090	(374,361)
Taxation payable							(3,344)
Bank borrowings							(100,000)
Obligations under finance leases							(3,453)
Other long-term loan							(7,200)
Consolidated total liabilities							<u>(488,358)</u>
OTHER INFORMATION							
Capital additions	44,313	7,288	5,807	10,128	1,395	–	68,931
Depreciation of property, plant and equipment	19,275	1,082	300	5,584	669	–	26,910
Amortisation of intangible assets	1,265	405	905	–	1,472	–	4,047
Amortisation of prepaid rental	94	–	–	–	–	–	94
Allowance for bad and doubtful debts (allowance written-back)	5,711	910	18	4,942	(503)	–	11,078
Net loss on disposal of property, plant and equipment	128	908	22	133	–	–	1,191
Impairment loss of intangible assets	–	1,861	2,714	–	–	–	4,575
Allowance for inventories (allowance written-back)	(5,541)	2,508	–	1,428	308	–	(1,297)
Impairment loss of goodwill	–	692	677	–	–	–	1,369

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2005

7. SEGMENT INFORMATION (Continued)

Business segments (Continued)

2004

	Boring machines RMB'000	Computerised embroidery machines RMB'000	Intelligent electrical appliances RMB'000	Turbo machines RMB'000	Laser prototyping machines RMB'000	Eliminations RMB'000	Consolidated RMB'000
REVENUE	<u>284,113</u>	<u>27,365</u>	<u>12,258</u>	<u>137,175</u>	<u>13,325</u>	<u>(4,800)</u>	<u>469,436</u>
SEGMENT RESULT	<u>20,788</u>	<u>(2,563)</u>	<u>(2,284)</u>	<u>13,602</u>	<u>516</u>	<u>(266)</u>	29,793
Other income							11,329
Finance costs							(8,966)
Impairment loss on other investments							(41,796)
Unallocated corporate expenses							<u>(725)</u>
Loss before tax							(10,365)
Income tax expense							<u>(4,076)</u>
Loss for the year							<u><u>(14,441)</u></u>

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2005

7. SEGMENT INFORMATION *(Continued)*

Business segments *(Continued)*

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

2004

	Boring machines <i>RMB'000</i>	Computerised embroidery machines <i>RMB'000</i>	Intelligent electrical appliances <i>RMB'000</i>	Turbo machines <i>RMB'000</i>	Laser prototyping machines <i>RMB'000</i>	Eliminations <i>RMB'000</i>	Consolidated <i>RMB'000</i>
ASSETS							
Segment assets	550,533	40,055	48,182	293,828	29,665	(45,023)	917,240
Unallocated corporate assets							206,065
Consolidated total assets							<u>1,123,305</u>
LIABILITIES							
Segment liabilities	(166,980)	(9,081)	(6,923)	(263,318)	(7,608)	44,830	(409,080)
Taxation payable							(4,408)
Bank borrowings							(137,091)
Obligations under finance lease							(3,688)
Other long-term loan							(7,200)
Consolidated total liabilities							<u>(561,467)</u>
OTHER INFORMATION							
Capital additions	39,166	1,846	4,066	54,449	658	–	100,185
Depreciation and amortisation							
of property, plant and equipment	21,999	1,002	304	2,226	443	–	25,974
Amortisation of goodwill	1,398	298	564	–	–	–	2,260
Amortisation of intangible assets	1,163	500	995	–	1,472	–	4,130
Amortisation of prepaid rental	93	–	–	–	–	–	93
Allowances for bad and doubtful debts	4,206	2,793	3,975	2,871	137	–	13,982
Net loss on disposal of property, plant and equipment	251	–	–	–	–	–	251
Allowance for inventories (allowance written-back)	(4,196)	701	(536)	–	–	–	(4,031)

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

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2005

8. OTHER INCOME

	2005 RMB'000	2004 RMB'000
Other income comprises:		
Interest income on deposits with banks	1,755	1,269
Investment income on other investments	—	4,890
Gain on disposal of other investments	—	168
VAT refund for new products	2,736	2,655
Government grant (Note 33)	1,350	1,350
Others	431	997
	<u>6,272</u>	<u>11,329</u>

9. FINANCE COSTS

	2005 RMB'000	2004 RMB'000
Interest on:		
– bank borrowings wholly repayable within five years	6,010	8,837
– obligations under finance leases	129	129
Total borrowing costs	<u>6,139</u>	<u>8,966</u>

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2005

10. PROFIT (LOSS) BEFORE TAX

	2005 RMB'000	2004 RMB'000
Profit (loss) before tax has been arrived at after charging:		
Staff costs including:		
Directors' and Supervisors' remuneration		
– Fees		
Executive Directors and Supervisors	200	204
Non-Executive Directors	93	96
Independent Non-Executive Directors	92	108
– Other emoluments		
Executive Directors and Supervisors	920	1,196
Non-Executive Directors	121	5
Independent non-executive directors	–	–
– Retirement schemes contributions	34	46
	<u>1,460</u>	<u>1,655</u>
Other retirement schemes contributions	5,557	5,209
Other staff costs	<u>77,052</u>	<u>57,666</u>
	<u>84,069</u>	<u>64,530</u>
Auditors' remuneration	1,849	1,804
Depreciation and amortisation		
– Amortisation of prepaid rental included in other expenses	94	93
– Amortisation of goodwill included in other expenses	–	2,260
– Amortisation of intangible assets included in other expenses	4,047	4,130
– Depreciation of property, plant and equipment		
– owned by the Group	26,261	25,325
– held under finance lease	649	649
	<u>31,051</u>	<u>32,457</u>
Total depreciation and amortisation	<u>31,051</u>	<u>32,457</u>
Net loss on disposal of property, plant and equipment	1,191	251
Research and development costs	2,543	2,205
Allowance for bad and doubtful debts	11,078	13,982
Impairment loss of intangible assets included in other expenses	4,575	–
Impairment loss of goodwill included in other expenses	1,369	–
Impairment loss of property, plant and equipment included in other expenses	5,164	–
Cost of inventories recognised as an expense	498,650	343,329
and after crediting:		
Amortisation of deferred gain included in administrative expenses	<u>201</u>	<u>201</u>

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2005

11. INCOME TAX EXPENSE

	2005 RMB'000	2004 RMB'000
The charge comprises:		
PRC income tax	<u>9,752</u>	<u>4,076</u>

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

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

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

	2005		2004	
	RMB'000	%	RMB'000	%
Profit (loss) before tax	<u>31,034</u>		<u>(10,365)</u>	
Tax at the PRC income tax rate of 15% (2004: 15%)	4,655	15.0	(1,555)	(15.0)
Tax effect of different tax rates in other jurisdictions	—	—	60	0.6
Tax effect of income not taxable for tax purpose	(69)	—	(1,207)	(11.6)
Tax effect of expenses not deductible for tax purpose	5,166	16.6	8,114	78.3
Tax effect of utilisation of previously unrecognised tax losses	—	—	(1,336)	(12.9)
Tax effect and for the year	<u>9,752</u>	<u>31.6</u>	<u>4,076</u>	<u>39.4</u>

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

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2005

12. DIRECTORS' REMUNERATION

The emoluments paid or payable to each of the fifteen (2004: fourteen) directors were as follows:

2005

	Fee RMB'000	Salaries and other benefits RMB'000	Performance related incentive payments RMB'000	Contribution to retirement benefits charges RMB'000	Total emoluments RMB'000
Executive Directors					
Lei Jinlu	20	—	—	—	20
Zhang Hanrong	24	191	52	10	277
Cheng Yunchuan	24	112	43	10	189
Wu Ketian	24	76	59	10	169
Yue Huafeng	12	—	—	—	12
Non-Executive Directors					
Wang Shangjin	20	180	—	—	200
Wen Peixiong	13	—	—	—	13
Luo Guowei	4	—	—	—	4
Guo Shangwu	24	—	—	—	24
Jiang Zhuangde	8	—	—	—	8
Zhang Chao	24	—	—	—	24
Independent Non-Executive Directors					
Yu Chengting	36	—	—	—	36
Tong Yunhuan	20	—	—	—	20
Dong Juan	36	—	—	—	36
Yu Weifeng Wayne	36	—	—	—	36
	325	559	154	30	1,068

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2005

12. DIRECTORS' REMUNERATION

2004

	Fee RMB'000	Salaries and other benefits RMB'000	Performance related incentive payments RMB'000	Contribution to retirement benefits charges RMB'000	Total emoluments RMB'000
Executive Directors					
Lei Jinlu	—	—	—	—	—
Zhang Hanrong	24	700	—	10	734
Cheng Yunchuan	24	271	—	10	305
Wu Ketian	24	102	—	10	136
Yue Huafeng	36	—	—	—	36
Non-Executive Directors					
Wang Shangjin	24	96	—	—	120
Wen Peixiong	—	—	—	—	—
Luo Guowei	—	—	—	—	—
Guo Shangwu	24	5	—	10	39
Jiang Zhuangde	24	—	—	—	24
Zhang Chao	24	—	—	—	24
Independent Non-Executive Directors					
Yu Chengting	36	—	—	—	36
Tong Yunhuan	36	—	—	—	36
Dong Juan	36	—	—	—	36
	<u>312</u>	<u>1,174</u>	<u>—</u>	<u>40</u>	<u>1,526</u>

The five highest paid individuals in the Group in 2005 and 2004 were all Directors of the Company and details of their emoluments are set out above.

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

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2005

13. NET PROFIT (LOSS) FOR THE YEAR

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

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

The Board of Directors proposed that no appropriation be made for the year ended 31st December, 2005.

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

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

15. EARNINGS (LOSS) PER SHARE

The calculation of earnings (loss) per share is based on the profit (loss) for the year attributable to equity holders of the parent of RMB11,001,000 (2004: loss of RMB17,586,000) and the 245,007,400 (2004: 245,007,400) shares in issue throughout the year.

No diluted earnings (loss) per share has been presented because the Company does not have any potential dilutive shares in issue during both years.

The following table summarises the impact of changes in accounting policies on the basic earnings (loss) per share as a result of:

	Impact on basic earnings (loss) per share	
	Year ended 31.12.2005 RMB cents	Year ended 31.12.2004 RMB cents
Reported figures before adjustment	3.6	(7.2)
Adjustments arising from changes in accounting policies (see Note 2)	0.9	—
Adjusted	4.5	(7.2)

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2005

16. PROPERTY, PLANT AND EQUIPMENT

	Land use right in PRC RMB'000	Buildings under medium term lease in the PRC RMB'000	Plant and machinery RMB'000	Furniture, fixtures and equipment RMB'000	Motor vehicles RMB'000	Construction- in-progress RMB'000	Total RMB'000
COST							
At 1st January, 2004	17,568	134,730	204,570	37,793	13,599	45,695	453,955
Additions	14,153	39,050	1,602	4,904	4,636	35,840	100,185
Transfers	–	11,204	9,869	1,675	–	(22,748)	–
Disposals	–	(605)	(846)	(10)	(661)	–	(2,122)
At 31st December, 2004							
– As originally stated	31,721	184,379	215,195	44,362	17,574	58,787	552,018
– Reclassified to prepaid lease payment	(31,721)	–	–	–	–	–	(31,721)
– As restated	–	184,379	215,195	44,362	17,574	58,787	520,297
Additions	–	1,814	31,748	3,222	2,851	29,246	68,881
Transfers	–	23,386	13,631	–	–	(37,017)	–
Transfers to jointly controlled entity	–	(3,277)	(357)	(81)	(1,019)	(2,929)	(7,663)
Disposals	–	(1,020)	(1,754)	(220)	(660)	–	(3,654)
At 31st December, 2005	–	205,282	258,463	47,283	18,746	48,087	577,861
DEPRECIATION AND AMORTISATION							
At 1st January, 2004	4,834	23,652	100,389	18,745	3,871	652	152,143
Provided for the year	321	3,930	15,054	4,184	1,502	983	25,974
Eliminated on disposals	–	(314)	(872)	(6)	(249)	–	(1,441)
At 31st December, 2004							
– As originally stated	5,155	27,268	114,571	22,923	5,124	1,635	176,676
– Reclassified to prepaid lease payments	(5,155)	–	–	–	–	–	(5,155)
– As restated	–	27,268	114,571	22,923	5,124	1,635	171,521
Provided for the year	–	7,309	15,064	3,247	1,290	–	26,910
Eliminated on transfers to jointly controlled entity	–	(1,338)	(180)	(14)	(109)	–	(1,641)
Impairment loss	–	–	4,229	–	–	935	5,164
Eliminated on disposals	–	(57)	(541)	(165)	(149)	–	(912)
At 31st December, 2005	–	33,182	133,143	25,991	6,156	2,570	201,042
NET BOOK VALUES							
At 31st December, 2005	–	172,100	125,320	21,292	12,590	45,517	376,819
At 31st December, 2004 (restated)	–	157,111	100,624	21,439	12,450	57,152	348,776

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2005

16. PROPERTY, PLANT AND EQUIPMENT *(Continued)*

The construction-in-progress are situated outside Hong Kong and are held under medium-term leases.

At 31st December, 2005, the Group's property, plant and equipment in respect of plant and machinery of approximately RMB3,488,000 which are held for rental income under operating lease.

At 31st December, 2005, the cumulative amount of interest capitalised in construction-in-progress amounted to approximately RMB261,000 (2004: RMB261,000).

The net book value of property, plant and equipment of the Group at 31st December, 2005 includes an amount of approximately RMB1,535,000 (2004: RMB2,248,000) in respect of plant and machinery held under finance leases.

17. PREPAID LEASE PAYMENTS

	2005 <i>RMB'000</i>	2004 <i>RMB'000</i>
The Group's prepaid lease payment comprises leasehold land in PRC under long lease	<u>25,892</u>	<u>26,566</u>
Analysed for reporting purposes as:		
Current asset	603	320
Non-current asset	<u>25,289</u>	<u>26,246</u>
	<u>25,892</u>	<u>26,566</u>

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

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2005

18. GOODWILL

	<i>RMB'000</i>
COST	
At 1st January, 2004 and at 1st January, 2005	24,430
Elimination of accumulated amortisation upon the application of HKFRS 3 (see Note 2)	(7,146)
Arising on additional interest in a subsidiary	50
At 31st December, 2005	17,334
AMORTISATION	
At 1st January, 2004	4,886
Charge for the year	2,260
At 1st January, 2005	7,146
Elimination of accumulation amortisation upon the application of HKFRS 3 (see Note 2)	(7,146)
At 31st December, 2005	–
IMPAIRMENT LOSS	
At 1st January, 2004 and 31st December, 2004	–
Impairment loss recognised during the year	(1,369)
At 31st December, 2005	(1,369)
CARRYING VALUES	
At 31st December, 2005	15,965
At 31st December, 2004	17,284

Goodwill acquired in a business combination is allocated, at acquisition, to the cash generating units (CGUs) that are expected to benefit from that business combination. The carrying amounts of goodwill as at 31st December, 2005 allocated to these CGUs are as follows:

	<i>RMB'000</i>
Laser prototyping machine	5,843
Computerised embroidery machines	2,037
Intelligent electrical appliances	3,270
Turbo machines	4,815
	15,965

Until 31st December, 2004, the amortisation period adopted for goodwill is 10 years.

The basis of the recoverable amounts of these CGUs and their major underlying assumptions are summarised below:

During the year ended 31st December, 2005, in view of the operating losses derived from the businesses of computerised embroidery machine and intelligent electrical appliances, management of the Group had determined that the recoverable amounts of goodwill derived from the CGUs of computerised embroidery machine and intelligent electrical appliances are less than their carrying values and impairment is considered necessary.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2005

18. GOODWILL (Continued)

The recoverable amounts of the computerised embroidery machine and intelligent electrical appliances are determined from value in use calculations. The key assumptions for the value in use calculations are those regarding the discount rates, growth rates and expected changes in selling prices and direct costs during the period. Management estimates discount rates using pre-tax rates that reflect current market assessments of the time value of money and the risks specific to these CGUs. The growth rates are based on industry growth forecasts. Changes in selling prices and direct costs are based on past practices and expectations of future changes in the market.

The Group prepares cash flow forecasts derived from the most recent financial budgets approved by management for the next year and extrapolates cash flows for the following four years based on an estimated growth rate ranges from 2%-5%. These rates do not exceed the average long-term growth rate for the relevant markets.

The rates used to discount the forecast cash flows for these CGUs is 5.1 per cent.

19. INTANGIBLE ASSETS

	<i>RMB'000</i>
COST	
At 1st January, 2004, 31st December, 2004 and 31st December, 2005	39,444
AMORTISATION AND IMPAIRMENT	
At 1st January, 2004	7,890
Charge for the year	4,130
At 31st December, 2004	12,020
Charge for the year	4,047
Impairment loss recognised in the year	4,575
At 31st December, 2005	20,642
CARRYING VALUES	
At 31st December, 2005	18,802
At 31st December, 2004	27,424

The intangible assets of the Group are technical knowhow.

Included in the technical knowhow is an amount of RMB8,838,000 and RMB6,786,000, representing the laser prototyping and manufacturing technology and the controllable centrifugal energy conservation compressor technology, respectively. The remaining balance of RMB3,178,000 represents the technical knowhow of developing intelligent computerised coloured embroidery machines and intelligent electrical appliances.

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

During the year ended 31st December, 2005, in view of the operating losses incurred in the business of computerised embroidery machine and intelligent electrical appliances, the Group recognised impairment losses of RMB4,575,000 in relation to the technical knowhows acquired by the subsidiaries of the Group for the usage of computerised embroidery machine and intelligent electrical appliances. The Directors considered the carrying values of these intangible assets are irrecoverable after taking into consideration the cash flow projections based on financial budgets prepared by the management to the extent of impairment losses recognised.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2005

20. DEFERRED COSTS

	Prepaid rental RMB'000
COST	
At 1st January, 2004, 31st December, 2004 and 31st December, 2005	4,486
AMORTISATION	
At 1st January, 2004	748
Charge for the year	93
At 31st December, 2004	841
Charge for the year	94
At 31st December, 2005	935
CARRYING VALUES	
At 31st December, 2005	3,551
At 31st December, 2004	3,645

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

21. INTEREST IN A JOINTLY CONTROLLED ENTITY

As at 31st December, 2005, the Group had interests in the following jointly controlled entity:

Name of entity	Form of business structure	Place of registration/operation	Proportion of nominal value of registered capital held by the Group	Proportion of voting power held	Principal activity
TOS Kunming Machine Tool Company Limited	Limited liability corporation	PRC	50%	50%	Design, development, manufacture and sale of machine tools

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2005

21. INTEREST IN A JOINTLY CONTROLLED ENTITY *(Continued)*

	2005 RMB'000	2004 RMB'000
Cost of unlisted investments in the jointly controlled entity	15,870	—
Share of results of jointly controlled entity	(921)	—
	<u>14,949</u>	<u>—</u>

The summarised financial information in respect of the Group's jointly controlled entity which is accounted for using the equity method is set out below:

	2005 RMB'000	2004 RMB'000
Total assets	52,325	—
Total liabilities	(4,689)	—
Net assets	<u>47,636</u>	<u>—</u>
Net assets of the jointly controlled entity attributable to the Group, net of unrealised fair value adjustments of property, plant and equipment contributed by the Group of RMB8,869,000	<u>14,949</u>	<u>—</u>
Revenue	<u>5,821</u>	<u>—</u>
Expenses	<u>(7,662)</u>	<u>—</u>
Loss for the year	<u>(1,841)</u>	<u>—</u>
Group's share of loss of the jointly controlled entity for the year	<u>(921)</u>	<u>—</u>

22. INVENTORIES

	2005 RMB'000	2004 RMB'000
Raw materials	55,294	46,996
Work-in-progress	146,630	165,269
Finished goods	<u>72,579</u>	<u>111,206</u>
	<u>274,503</u>	<u>323,471</u>

During the year, there was an increase in the net realisable value of inventories due to market trend. As a result, a reversal of write-back of inventories of RMB1,297,000 (2004: RMB4,031,000) has been recognised and included in cost of sales in the current year.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2005

23. TRADE RECEIVABLES

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

	2005 RMB'000	2004 RMB'000
Within one year	86,076	82,035
Between one to two years	17,545	12,857
Between two to three years	930	806
Over three years	384	577
	<u>104,935</u>	<u>96,275</u>

In the opinion of the Directors, the fair value of the Group's trade receivables at 31st December, 2005 approximate to their corresponding carrying amounts.

24. OTHER RECEIVABLES

The amounts are unsecured, interest-free and repayable on demand.

In the opinion of the directors, the fair value of the Group's other receivables at 31st December, 2005 approximate to their corresponding carrying amounts.

25. AMOUNT DUE FROM A RELATED COMPANY

Particulars of the amount due from the related company are as follows:

Name of company		Balance at 12.31.2005 RMB'000	Balance at 1.1.2005 RMB'000	Maximum amount outstanding during the year RMB'000
	Notes			
Pharmacy Group of Xian Jiaotong University	1	9,500	—	<u>10,000</u>
Xian Jiaotong University Industrial (Group) Incorporation	2	<u>100</u>	<u>—</u>	<u>100</u>
		<u>9,600</u>	<u>—</u>	

Notes:

1. Pharmacy Group of Xian Jiaotong University is a company with common substantial shareholder and the amount is unsecured, interest-bearing at 5.5% and is repayable on demand.
2. Xian Jiaotong University Industrial (Group) Incorporation is a company with common substantial shareholder and the amount is unsecured, interest-free and is repayable on demand.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2005

26. AVAILABLE-FOR-SALE INVESTMENTS

Available-for-sale investments as at the balance sheet date comprises:

	2005 RMB'000	2004 RMB'000
Unlisted unit fund in the PRC (<i>Note i</i>)	871	—
Listed shares in the PRC (<i>Note ii</i>)	7,653	—
	<u>8,524</u>	<u>—</u>

Notes:

- (i) At the balance sheet date, all available-for-sale investments are stated at fair value. Fair value of those investments have been determined by reference to the unit prices quoted by security house.
- (ii) During the year ended 31st December, 2004, the Company entered into an agreement with China Fortune Securities ("China Fortune") for the Trusteeship of the Management of Investment in State Bonds (the "Trusteeship Agreement"), pursuant to which the Company entrusted China Fortune to conduct investment on State Bonds with RMB50,000,000 (the "Funds") with a term of the entrustment of one year from 23rd February, 2004 to 23rd February, 2005.

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

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

During the year ended 31st December, 2005, another discussion was held with the officials of China Huarong, the Company further noted that China Huarong was still in negotiation with the major shareholders of China Fortune to crystallise the plan to recover the Funds.

In the opinion of the directors, the Company has good claims on the underlying assets held in the investment account with China Fortune despite that China Fortune had breached its contract and such investments have been accounted for as available-for-sale investments in amount of RMB7,653,000 as at 31st December, 2005.

Fair value of these available-for-sales investments have been determined by reference to bid prices quoted in the active markets.

27. OTHER INVESTMENTS

Other investments as at 31st December, 2004 represented unlisted unit fund and listed shares in the PRC. Upon the application of HKAS 39 on 1st January, 2005, other investments were reclassified to available-for-sale investments under HKAS 39 (see Note 2 for details).

28. PLEDGED BANK DEPOSITS

The amounts represent deposits pledged to banks to secure banking facilities granted to the Group. Deposits amounting to RMB2,109,000 (2004: RMB7,711,000) have been pledged to secure short-term bank loans and therefore classified as current assets.

The deposits carry fixed interest rate of approximately 2%. The pledged bank deposits will be released upon the settlement of relevant bank borrowings. The fair value of bank deposits at 31st December, 2005 approximates to their corresponding carrying amounts.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2005

29. BANK BALANCES AND CASH

Bank balances and cash comprises cash held by the Group and short term bank deposits with an original maturity of three months or less. The deposits carry at prevailing market interest rate of approximately 1% (2004: 1%) per annum. In the opinion of the Directors, the fair value of bank deposits at 31st December, 2005 approximates to their corresponding carrying amounts.

30. TRADE PAYABLES

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

	2005 RMB'000	2004 RMB'000
Within one year	77,648	60,022
Between one to two years	18,901	1,872
Between two to three years	450	261
Over three years	1,328	1,352
	<u>98,327</u>	<u>63,507</u>

In the opinion of the Directors, the fair value of the Group's trade payables at 31st December, 2005 approximates to their corresponding carrying amounts.

31. ADVANCES FROM CUSTOMERS

The advances are unsecured, interest free and repayable on demand.

In the opinion of the Directors, the fair value of the Group's advances from customers at 31st December, 2005 approximates to their corresponding carrying amounts.

32. OTHER PAYABLES

Included in the other payables amount is a payable for land appreciation tax ("LAT") of RMB8,849,000. Pursuant to a letter issued by the Yunnan Provincial Government in April 2002 relating to the transfer of land and buildings (the "Transfer") upon the restructuring of the Group in 2001, the Yunnan Provincial Government had concurred with the opinion of the Yunnan Local Tax Bureau that the Company could temporarily be exempted from the LAT regarding the Transfer and no provision for LAT had been made by the Company accordingly for these years. In March 2005, The State Administration of Tax issued a tax demand letter to the Yunnan Provincial Government which stated that the Company is subject to LAT on the Transfer in an amount of RMB10,894,000. In November 2005, the Company lodged a request to the Yunnan Provincial Government to negotiate with The State Administration of Tax on such tax demand. However, despite its request to Yunnan Provincial Government, the Directors' are of the opinion that there is a probable chance that The State Administration of Tax will persist for payment of LAT as demanded from the Company. Accordingly, the Company provided RMB10,894,000 of LAT as demanded, of which RMB2,000,000 had been paid for during the year.

In the opinion of the Directors, the fair value of the Group's other payables at 31st December, 2005 approximates to their corresponding carrying amounts.

33. DEFERRED INCOME

During the year, the Group received government subsidy of approximately RMB4,007,000 (2004: RMB1,350,000) towards the cost for the upgrades of its manufacturing plant. The amount has been treated as deferred income and is transferred to income over the useful lives of the relevant assets.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2005

34. AMOUNTS DUE TO RELATED COMPANIES

Both the company and the related companies have the same common substantial shareholder and the amounts are unsecured, interest-free and repayable on demand.

In the opinion of the Directors, the fair value of the amounts due to related companies approximates to their corresponding carrying amounts.

35. OBLIGATIONS UNDER FINANCE LEASES

	Minimum lease payments		Present value of minimum lease payments	
	2005 RMB'000	2004 RMB'000	2005 RMB'000	2004 RMB'000
The maturity of obligations under finance leases is as follows:				
Within one year	366	366	235	235
In the second to fifth year inclusive	5,156	5,520	3,218	3,453
	5,522	5,886	3,453	3,688
Less: Future finance charge	(2,069)	(2,198)	—	—
Present value of obligations under finance leases	3,453	3,688	3,453	3,688
Less: Amount due for settlement within one year (shown under current liabilities)			(235)	(235)
Amount due after one year			3,218	3,453

All leases are on a fixed rate and fixed repayment basis and no arrangements have been entered into for contingent rental payments. The average term of the finance leases entered into is 20 years (2004: 20 years).

The fair value of the Group's finance lease obligations, determined based on the present value of the estimated future cash flows discounted using the prevailing market rate at the balance sheet date approximates to their carrying value.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2005

36. BANK BORROWINGS

	2005 RMB'000	2004 RMB'000
The maturity of the bank borrowings is as follows:		
In one year or less	60,000	137,091
In more than one year but not more than two years	40,000	—
	<u>100,000</u>	<u>137,091</u>
Analysed as:		
— secured	34,000	54,000
— unsecured	66,000	83,091
	<u>100,000</u>	<u>137,091</u>

Bank borrowings comprise:

	Maturity date	Effective interest rate	Carrying amount	
			2005 RMB'000	2004 RMB'000
Fixed rate borrowing 5.859%				
Secured RMB bank loan of RMB20,000,000	November 2006	5.859%	20,000	—
Fixed rate borrowing 5.58%				
Unsecured RMB bank loan of RMB26,000,000	March 2006	5.58%	26,000	—
Fixed rate borrowing 5.58%				
Secured RMB bank loan of RMB14,000,000	March 2006	5.58%	14,000	—
Fixed rate borrowing 5.76%				
Unsecured RMB bank loan of RMB40,000,000	March 2007	5.76%	40,000	—
Fixed rate borrowing 5.5755%				
Secured RMB bank loan of RMB20,000,000	September 2005	5.5755%	—	20,000
Fixed rate borrowing 4.779%				
Secured RMB bank loan of RMB44,000,000	March 2005	4.779%	—	44,000
Fixed rate borrowing 4.779%				
Unsecured RMB bank loan of RMB30,000,000	March 2005	4.779%	—	30,000
Fixed rate borrowing 4.779%				
Unsecured RMB bank loan of RMB24,000,000	May 2005	4.779%	—	24,000
Fixed rate borrowing 5.22%				
Secured RMB bank loan of RMB10,000,000	June 2005	5.22%	—	10,000
Fixed rate borrowing 5.04%				
Unsecured RMB bank loan of RMB5,000,000	May 2005	5.04%	—	5,000
Fixed rate borrowing 5.04%				
Unsecured RMB bank loan of RMB4,091,000	June 2005	5.04%	—	4,091
			<u>100,000</u>	<u>137,091</u>

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2005

36. BANK BORROWINGS *(Continued)*

The fair value of the Group's borrowings estimated by discounting their future cash flows at the prevailing market borrowing rates at the balance sheet date for similar borrowings are as follows:

	2005 RMB'000	2004 RMB'000
Fixed-rate bank loans	94,599	129,687

37. SHARE CAPITAL

	Registered, issued and fully paid 2005 & 2004 RMB'000
Ordinary shares of RMB1 each	
– A shares	180,007
– H shares	65,000
	245,007

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

38. DEFERRED GAIN

	RMB'000
GROSS AMOUNT	
At 1st January, 2004, 31st December, 2004 and 31st December, 2005	4,023
AMORTISED TO INCOME	
At 1st January, 2004	402
Amortised during the year	201
At 31st December, 2004	603
Amortised during the year	201
At 31st December, 2005	804
CARRYING AMOUNTS	
At 31st December, 2005	3,219
At 31st December, 2004	3,420

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

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2005

39. OTHER LONG-TERM LOAN

Other long-term loan which is unsecured and non-interest bearing, represents government grant for working capital of a construction project which is still in progress and such amount will not be repayable until the project is completed. In the opinion of the directors, the project will not be completed within the next twelve months and the fair value of the loan amount approximates to its carrying value.

40. OPERATING LEASE COMMITMENTS

The Group as Lessee

Minimum lease payments paid under operating leases during the year:

	2005 RMB'000	2004 RMB'000
Land and buildings	2,760	2,987

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

	2005 RMB'000	2004 RMB'000
Within one year	2,242	2,217
In second to fifth year inclusive	8,738	8,027
Over five years	23,690	19,883
	34,670	30,127

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

41. CAPITAL COMMITMENTS

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

	2005 RMB'000	2004 RMB'000
Capital expenditure contracted for but not provided in the financial statements		
– Acquisition of property, plant and equipment	–	4,195
– Construction in progress	47,293	20,613
	47,293	24,808

42. PLEDGE OF ASSETS

At the balance sheet date, the Group had pledged land and buildings having a net book value of approximately RMB21,915,000 (2004: RMB51,448,000) and pledged time deposits of RMB2,109,000 (2004: RMB7,711,000) to secure bank loans granted to the Group.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2005

43. RETIREMENT BENEFIT SCHEME

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

During the year, the contributions made by the Group relating to the arrangement were approximately RMB5,591,000 (2004: RMB5,255,000). There was no forfeited contribution for reduction in the Company's future contribution during the year.

44. MAJOR NON-CASH TRANSACTIONS

During the year, the Group disposed of two buildings in an aggregate carrying amounts of approximately RMB548,000 to a director and an employee of the Company in lieu of cash bonuses due to them.

Part of the consideration for the establishment of the jointly controlled entity during the year represents the transfer of property, plant and equipment at an aggregate carrying value of approximately RMB6,022,000 in lieu of cash.

During the year, the Group transferred its inventories at cost of approximately RMB4,081,000 to property, plant and equipment.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2005

45. CONNECTED PARTIES AND RELATED PARTY TRANSACTIONS AND BALANCES

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

CONNECTED AND RELATED PARTIES

(A) TRANSACTIONS

Name of company	Nature of transactions	2005 RMB'000	2004 RMB'000
<i>Substantial shareholders of the Company</i>			
Jiaotong Group (including its associates as defined by the Listing Rules, other than members of the Group)	Purchases of materials from Jiaotong Group (Note a)	1,748	2,168
	Research and development expenditure paid to Jiaotong Group (Note b)	1,150	1,508
	Utility service fee paid to Jiaotong Group (Note c)	776	847
	Rental expenses (Note c)	587	565
	Guarantees given by Jiaotong Group	—	20,000
	Sales of finished goods to Jiaotong Group	1,297	—
	License fee for operating services in university buildings	1,229	—
	Interest income from short-term borrowing	101	—
Yunnan Provincial People's Government ("Yunnan Government")	Rental for buildings to Yunnan Government (Note d)	—	458
	Rental for land to Yunnan Government (Note d)	—	1,200
	Interest expenses on obligations under finance lease paid to Yunnan Government (Note e)	129	129
<i>Company controlled by the substantial shareholders</i>			
Kun Ji Group (including its associates as defined by the Listing Rules, other than members of the Group)	Payment to Kun Ji Group for building management fees, and provision of social, education and medical services to the Company's employees (Note f)	1,269	1,600
	Sales of finished goods to Kun Ji Group (Note a)	356	699
	Rental for building to Kun Ji Group	2,170	—
	Construction costs	740	—
		<u>740</u>	<u>—</u>
<i>Directors of the Company</i>			
Mr. Zhang Hanrong	Disposal of building to a director in lieu of cash bonuses due to him	267	—
<i>Jointly controlled entity</i>			
TOS Kunming Machine Tool Company Limited ("TOS")	Sales of finished goods to TOS	1,913	—
	Purchases of material from TOS	6,600	—
		<u>6,600</u>	<u>—</u>

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2005

45. CONNECTED PARTIES AND RELATED PARTY TRANSACTIONS AND BALANCES

CONNECTED AND RELATED PARTIES (Continued)

(B) BALANCES

Name of company	Nature of transactions	2005 RMB'000	2004 RMB'000
<i>Substantial shareholder of the Company</i>			
Jiaotong Group	Balance due from (to) Jiaotong Group		
	– advance to Jiaotong Group	9,600	–
	– prepayments (note g)	–	249
	– non-trade payable (note g)	(475)	(1,440)
		<u>9,125</u>	<u>(1,191)</u>
Yunnan Government	Balance of obligations under finance leases due to Yunnan Government (note g)	<u>(3,453)</u>	<u>(3,688)</u>
<i>Company controlled by the substantial shareholders</i>			
Kun Ji Group	Balance due to Kun Ji		
	– trade payable (note g)	(30)	(285)
	– non-trade payable (note g)	(1,783)	(1,921)
		<u>(1,813)</u>	<u>(2,206)</u>

Notes:

- In the opinion of the Directors, these transactions were carried out at market price or, where no market price was available, at cost plus a percentage profit mark up, or determined and agreed by both parties.
- Research and development expenditure was determined by terms agreed by both parties.
- The Company entered into an agreement with Jiaotong Group whereby Jiaotong Group provides certain housing facilities and utilities services to the subsidiaries at prices to be determined by reference to the State stipulated price for utility services. The agreement has a term of three years commencing 31st December, 2001.
- Upon disposal of its land and buildings to Yunnan Government during the year ended 31st December, 2002, the Group entered into separate agreements to lease back certain land and buildings for its use for a term of 20 years. The annual rental is approximately RMB1,200,000 per annum for the lease back of land and approximately RMB458,000 per annum for the lease back of buildings which were determined by reference to the prevailing market rates as certified by a professional valuer. The rental will be revised every three years based on market rates as certified by professional valuers. Details of these lease arrangement are set out in a circular to shareholders dated 5th December, 2002.
- Upon disposal of its land and buildings to Yunnan Government during the year ended 31st December, 2001, the Group entered into separate agreements with Yunnan Government to lease back certain land and buildings for a term of 20 years. The balance with Yunnan Government as the lessor of these arrangement are set out in note 35, obligations under finance leases. The relevant interest expenses on obligations under finance leases were determined with reference to the prevailing market rates.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2005

45. CONNECTED PARTIES AND RELATED PARTY TRANSACTIONS AND BALANCES *(Continued)*

CONNECTED AND RELATED PARTIES *(Continued)*

(B) BALANCES (Continued)

Notes: (Continued)

- (f) The receipt and payment of these service income and expenses were priced with reference to a composite services agreement entered into between Kun Ji Group and the Company in 1993 and renewed in 2004.
- (g) The balances are unsecured, interest-free and repayable on demand.
- (h) The Group has disposed two buildings in an aggregate carrying amounts of approximately RMB548,000 to a director and an employee of the Company in lieu of cash bonuses due to them.

46. PRINCIPAL SUBSIDIARIES

Details of the Company's subsidiaries at 31st December, 2005 are as follows:

Name of subsidiary	Form of business structure	Place of incorporation and operations	Registered capital	Proportion of registered capital held by the Company		Principal activities
				Directly	Indirectly	
Xian Ser Turbo Machinery Equipment Company Limited ("Xian Ser")	Limited liability	PRC	RMB50,000,000	45% (Note)	–	Design, develop and sales of turbo-machinery
Changsha Ser Turbo Machinery Equipment Company Limited	Limited liability	PRC	RMB10,000,000	–	95%	Design, develop and sales of turbo-machinery
Hangzhou Ser Gas Engineering Company Limited	Limited liability	PRC	RMB1,200,000	–	51%	Design, develop and sales of turbo-machinery
Shanxi Hengtong Intelligent Machine Company Limited ("Hengtong")	Limited liability	PRC	RMB27,960,000	65.34%	–	Develop and sale of manufacturing moulds, machinery, equipment, electronic products, software and hardware
Xian Jiaotong University Siyuan Intelligent Electric Apparatus Company Limited ("Intelligent")	Limited liability	PRC	RMB35,000,000	78.03%	–	Research, develop manufacturing and sale of automatic machines for industries such as water utilities, civil engineering and construction

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2005

46. PRINCIPAL SUBSIDIARIES *(Continued)*

Name of subsidiary	Form of business structure	Place of incorporation and operations	Registered capital	Proportion of registered capital held by the Company		Principal activities
				Directly	Indirectly	
Winko Machines Company Limited ("Winko")	Limited liability	PRC	RMB20,230,000	95.50%	–	Research, develop, manufacturing and sale of intelligent computerised coloured embroidery machines

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

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

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2005

47. BALANCE SHEET OF THE COMPANY

	NOTES	2005 RMB'000	2004 RMB'000
Non-current assets			
Property, plant and equipment		277,895	260,836
Investments in subsidiaries		92,162	91,232
Advances to subsidiaries		–	756
Intangible assets		6,875	8,141
Deferred costs		3,551	3,645
Prepaid lease payment		11,773	12,093
Investment in jointly controlled entity		15,870	–
		408,126	376,703
Current assets			
Inventories		175,649	209,795
Trade receivables		52,412	46,035
Other receivables, deposits and prepayments		19,090	12,474
Amounts due from subsidiaries	(a)	19,557	–
Other investments		–	9,204
Available-for-sales investments		8,523	–
Prepaid lease payment		321	321
Bank balances and cash		116,260	121,861
		391,812	399,690
Current liabilities			
Trade payables		40,756	21,588
Advances from customers		98,944	107,213
Other payables		37,932	29,159
Amounts due to subsidiaries	(b)	179	3,526
Amounts due to related companies		1,903	2,073
Taxation payable		1,253	1,906
Obligations under finance leases – due within one year		213	213
Bank borrowings – due within one year		40,000	98,000
		221,180	263,678
Net current assets		170,632	136,012
		578,758	512,715
Capital and reserves			
Share capital		245,007	245,007
Reserves	(c)	287,334	260,877
		532,341	505,884
Non-current liabilities			
Obligations under finance leases – due after one year		3,198	3,411
Deferred gain		3,219	3,420
Bank borrowings – due after one year		40,000	–
		46,417	6,831
		578,758	512,715

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2005

47. BALANCE SHEET OF THE COMPANY (Continued)

Notes:

(a) **Amounts due from subsidiaries**

The amounts due from subsidiaries of the Company are unsecured, interest-free and repayable on demand.

(b) **Amounts due to subsidiaries**

The amounts due to subsidiaries represent trade payables to the non-wholly owned subsidiaries. The advance an unsecured, interest-free and repayable on demand.

(c) **Reserves**

	Share premium RMB'000	Capital reserve RMB'000	Statutory surplus reserve RMB'000	Statutory public welfare fund RMB'000	Accumulated losses RMB'000	Total RMB'000
At 1st January, 2004	293,745	10,225	8,406	8,406	(44,903)	275,879
Net loss for the year	—	—	—	—	(15,002)	(15,002)
At 31st December, 2004	293,745	10,225	8,406	8,406	(59,905)	260,877
Net profit for the year	—	—	—	—	26,457	26,457
At 31st December, 2005	<u>293,745</u>	<u>10,225</u>	<u>8,406</u>	<u>8,406</u>	<u>(33,448)</u>	<u>287,334</u>