TO THE SHAREHOLDERS OF
DONGFANG ELECTRICAL MACHINERY COMPANY LIMITED
東方電機股份有限公司
(established in the Deyang City, Sichuan Province, the People's Republic of China ("PRC") with limited liability)

We have audited the consolidated financial statements of Dongfang Electrical Machinery Company Limited (the "Company") and its subsidiaries (collectively referred to as the "Group") set out on pages 43 to 80, which comprise the consolidated balance sheet as at 31 December 2006, and the consolidated income statement, the consolidated statement of changes in equity and the consolidated cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

DIRECTORS' RESPONSIBILITY FOR THE CONSOLIDATED FINANCIAL STATEMENTS

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

AUDITOR'S RESPONSIBILITY

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

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

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

OPINION

In our opinion, the consolidated financial statements give a true and fair view of the state of affairs of the Group as at 31 December 2006 and of the Group's profit and cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards and have been properly prepared in accordance with the disclosure requirements of the Hong Kong Companies Ordinance.

Deloitte Touche Tohmatsu
Certified Public Accountants

Hong Kong
2 April 2007

Consolidated Income Statement

For the year ended 31 December 2006
(prepared in accordance with Hong Kong Financial Reporting Standards)

	NOTES	2006 RMB'000	2005 RMB'000
Revenue	6	**4,698,079**	3,047,858
Cost of sales		**(3,384,895)**	(2,094,581)
Gross profit		**1,313,184**	953,277
Other income	7	**179,864**	126,774
Distribution expenses		**(30,025)**	(20,989)
Administrative expenses		**(503,409)**	(440,589)
Finance costs	8	**(314)**	(1,272)
Profit before tax		**959,300**	617,201
Income tax expense	9	**(94,244)**	(82,213)
Profit for the year	10	**865,056**	534,988
Attributable to:			
Equity holders of the parent		**864,708**	534,698
Minority interests		**348**	290
		865,056	534,988
Dividends recognised as distribution during the year:			
Final dividend of RMB0.5 (2004: RMB0.12) per share, paid	12	**225,000**	54,000
Proposed final dividend of RMB0.2 (2005: RMB0.5) per share	12	**90,000**	225,000
Earnings per share			
basic	13	**RMB1.922**	RMB1.188
diluted	13	**RMB1.922**	RMB1.188

Consolidated Balance Sheet

At 31 December 2006
(prepared in accordance with Hong Kong Financial Reporting Standards)

	NOTES	**2006** ***RMB'000***	2005 *RMB'000* *(Restated)*
Non-current assets			
Property, plant and equipment	14	**665,234**	541,893
Construction in progress	15	**49,652**	151,654
Prepaid lease payments	16	**27,745**	26,363
Investment properties	17	**26,029**	27,141
Intangible assets	18	**2,040**	1,427
Interests in an associate	19	**—**	—
Interest in a jointly controlled entity	20	**23,375**	6,375
Available-for-sale investments	21	**1,499**	1,499
Deferred tax assets	22	**48,816**	—
		844,390	756,352
Current assets			
Inventories	23	**2,420,883**	1,794,023
Amount due from an associate	24	**717**	904
Trade and other receivables	25	**2,516,145**	1,623,534
Prepaid lease payments	16	**1,148**	713
Amounts due from customers for contract works	26	**569,812**	259,869
Bank deposits with maturity over three months		**1,215,341**	1,957,009
Pledged bank deposits	27	**135,571**	154,254
Bank balances and cash	27	**1,926,466**	1,916,230
		8,786,083	7,706,536
Current liabilities			
Amounts due to customers for contract works	26	**1,971,852**	1,835,767
Trade and other payables	28	**4,887,435**	4,655,361
Enterprise income tax liabilities		**149,743**	87,456
Other tax liabilities	29	**73,064**	38,814
Borrowings	30	**—**	10,000
Provision	31	**38,045**	—
Deferred income	32	**29,842**	22,063
		7,149,981	6,649,461
Net current assets		**1,636,102**	1,057,075
Total assets less current liabilities		**2,480,492**	1,813,427

At 31 December 2006
(prepared in accordance with Hong Kong Financial Reporting Standards)

	NOTES	**2006** **RMB'000**	2005 RMB'000 (Restated)
Non-current liabilities			
Deferred income	32	**140,037**	113,698
Long term liabilities		**685**	—
		140,722	113,698
Net assets		**2,339,770**	1,699,729
Capital and reserves			
Share capital	33	**450,000**	450,000
Reserves		**1,888,165**	1,248,457
Equity attributable to equity holders of the parent		**2,338,165**	1,698,457
Minority interests		**1,605**	1,272
		2,339,770	1,699,729

The consolidated financial statements on pages 43 to 80 were approved and authorised for issue by the Board of Directors on 2 April 2007.

CHAIRMAN

DIRECTOR

Consolidated Statement of Changes in Equity

For the year ended 31 December 2006
(prepared in accordance with Hong Kong Financial Reporting Standards)

	Attributable to equity holders of the parent								
	Share capital	Capital surplus	Statutory surplus reserve	Statutory public welfare fund	Dividend reserve	Retained earnings	Total	Minority interests	Total
	RMB'000	*RMB'000*	*RMB'000*	*RMB'000*	*RMB'000*	*RMB'000*	*RMB'000*	*RMB'000*	*RMB'000*
At 1 January 2005	450,000	636,061	39,182	31,793	54,000	6,723	1,217,759	1,028	1,218,787
Profit for the year and total recognised income for the year	—	—	—	—	—	534,698	534,698	290	534,988
Transfers	—	—	53,510	26,754	—	(80,264)	—	—	—
Dividends paid to minority shareholders	—	—	—	—	—	—	—	(46)	(46)
Dividend paid	—	—	—	—	(54,000)	—	(54,000)	—	(54,000)
Proposed final 2005 dividend	—	—	—	—	225,000	(225,000)	—	—	—
At 31 December 2005	450,000	636,061	92,692	58,547	225,000	236,157	1,698,457	1,272	1,699,729
Profit for the year and total recognised income for the year	—	—	—	—	—	864,708	864,708	348	865,056
Transfers	—	—	134,287	(58,547)	—	(75,740)	—	—	—
Dividends paid to minority shareholders	—	—	—	—	—	—	—	(15)	(15)
Dividend paid	—	—	—	—	(225,000)	—	(225,000)	—	(225,000)
Proposed final 2006 dividend	—	—	—	—	90,000	(90,000)	—	—	—
At 31December 2006	450,000	636,061	226,979	—	90,000	935,125	2,338,165	1,605	2,339,770

In accordance with the PRC Company Law and relevant Articles of Association of the Company, capital surplus includes share premiums, gifts and donations received and others in accordance with the relevant regulations. Capital reserve shall only be used for capitalisation into share capital.

In accordance with the PRC Company Law and the relevant Articles of Association, the Company and its subsidiaries are required to appropriate amounts equal to 10% and 5% respectively of their profit after taxation as determined in accordance with the PRC accounting standards to each of the statutory surplus reserve and statutory public welfare fund respectively.

Statutory surplus reserve is part of shareholders' equity and when its balance reaches an amount equal to 50% of the registered capital, further appropriation need not be made. According to the PRC Company Law, 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 statutory surplus reserve are converted to capital, the funds remaining in such reserve shall amount to not less than 25% of the registered capital.

Statutory public welfare fund is also part of shareholders' equity. According to the PRC Company Law, it shall only be applied for capital expenditure related to the provision of collective welfare for staff and workers and these welfare facilities remain as property of the Group. Statutory public welfare fund is non-distributable other than upon liquidation. It is transferred to statutory surplus reserve under the new modification of the PRC Company Law in 2006.

For the year ended 31 December 2006
(prepared in accordance with Hong Kong Financial Reporting Standards)

	2006 RMB'000	2005 RMB'000
OPERATING ACTIVITIES		
Profit before tax	**959,300**	617,201
Adjustments for:		
Finance costs	**314**	1,272
Interest income	**(63,464)**	(47,036)
Realisation of deferred income	**(42,524)**	(6,664)
Reversal of impairment losses on property, plant and equipment	**(1,161)**	—
Depreciation and amortisation	**105,901**	98,251
Allowance for bad and doubtful debts	**44,814**	11,215
Operating lease rentals in respect of prepaid lease payments	**713**	—
Inventories written off	**5,669**	656
Reversal of write down for inventories	**(845)**	(2,597)
(Gain) loss on disposal of property, plant and equipment and construction in progress	**(1,191)**	2,380
Loss on disposal of an associate	**—**	43
Operating cash flows before movements in working capital	**1,007,526**	674,721
Increase in inventories	**(631,684)**	(867,641)
(Increase) decrease in net amounts due to/from customers for contract works	**(173,858)**	1,213,832
Increase in trade receivables and other receivables	**(775,620)**	(410,504)
Increase in trade payables and other payables	**197,558**	392,239
Increase in deferred income	**76,642**	89,969
Increase (decrease) in other tax liabilities	**34,250**	(85,610)
Increase in provision	**38,045**	—
Cash (used in) generated from operations	**(227,141)**	1,007,006
PRC enterprise income tax paid	**(80,773)**	(55,365)
NET CASH (USED IN) FROM OPERATING ACTIVITIES	**(307,914)**	951,641
INVESTING ACTIVITIES		
Decrease in amount due from an associate	**187**	1,459
Decrease (increase) in bank deposits with maturity over three months and pledged bank deposits	**760,351**	(1,480,745)
Purchase of property, plant and equipment	**(1,399)**	(6,986)
Prepayment for / purchase of construction in progress	**(199,786)**	(172,157)
Purchase of intangible assets	**(1,283)**	(54)
Proceeds from disposal of an associate	**—**	70
Acquisition of a jointly controlled entity	**(17,000)**	(6,375)
Interest received	**9,577**	47,036
Proceeds from disposal of property, plant and equipment	**3,172**	895
NET CASH FROM (USED IN) INVESTING ACTIVITIES	**553,819**	(1,616,857)

Consolidated Cash Flow Statement *(continued)*

For the year ended 31 December 2006
(prepared in accordance with Hong Kong Financial Reporting Standards)

	2006	2005
	RMB'000	*RMB'000*
FINANCING ACTIVITIES		
Dividends paid	**(225,000)**	(54,000)
Repayment of loans	**(20,000)**	(40,000)
New loans raised	**10,000**	10,000
Interest paid	**(314)**	(1,836)
Dividends paid to minority shareholders	**(15)**	(46)
NET CASH USED IN FINANCING ACTIVITIES	**(235,329)**	(85,882)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	**10,576**	(751,098)
CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE YEAR	**1,916,230**	2,667,328
Effects of exchange rate changes on the balance of cash held in foreign currencies	**(340)**	—
CASH AND CASH EQUIVALENTS AT THE END OF THE YEAR represented by:		
Bank balances and cash	**1,926,466**	1,916,230

1. GENERAL

The Company was established on 28 December 1993 in Deyang, Sichuan, the PRC as a joint stock limited company. With effect from the same date, the Company assumed the business of manufacture and selling power equipment, electric motors and their respective auxiliary parts together with the relevant assets and liabilities from Dongfang Electrical Machinery Works ("DFEW"). On 31 May 1994, the Company placed and issued 170,000,000 overseas listed foreign investment shares (the "H Shares") to the public in Hong Kong and the H Shares have been listed on The Stock Exchange of Hong Kong Limited since 6 June 1994. On 4 July 1995, with the approval of the relevant authorities including the Securities Regulatory Commission of the PRC, the Company issued 60,000,000 domestic listed Renminbi ordinary shares (the "A Shares") in the PRC. The A Shares have been listed on the Shanghai Stock Exchange since 10 October 1995. On 30 December 2005, the State-owned Assets Supervision and Administration Commission promulgated "Approval of certain issues in the transfer of state-owned shares of Dongfang Electrical Machinery Company Limited" (National asset rights [2005] No. 1604) (《關於東方電機股份有限公司國有股劃轉有關問題的批復》(國資產權[2005]1604號) to approve the transfer of 220,000,000 State-owned domestic shares, representing DFEW's 48.89% of the share capital of the Company, from DFEW to Dongfang Electric Corporation ("DEC"). DEC is also the holding entity of DFEW.

The Company's ultimate holding entity is DEC, a state-owned enterprises incorporated in the PRC. The address of the registered office and principal place of business of the Company are disclosed in the "Company Profile" section to the annual report.

The Group is principally engaged in the business of manufacture and sale of main thermal power equipment, main hydro power equipment, AC/DC motors as well as provision of engineering and repairing services.

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

2. APPLICATION OF NEW AND REVISED HONG KONG FINANCIAL REPORTING STANDARDS ("HKFRS")

In the current year, the Group has applied, for the first time, a number of new standards, amendments and interpretations (the "new HKFRS") issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA"), which are either effective for accounting periods beginning on or after 1 December 2005 or 1 January 2006. The adoption of the new HKFRS had no material effect on how the results for the current or prior accounting periods have been prepared and presented. Accordingly, no prior period adjustment is required.

The Group has not early applied the following new standards, amendment and interpretations that have been issued but are not yet effective. The directors of the Company anticipate that the application of these new standards, amendment and interpretation will have no material impact on the consolidated financial statements of the Group.

HKAS 1 (Amendment)	Capital disclosures [1]
HKFRS 7	Financial instruments: Disclosures [1]
HKFRS 8	Operating Segments [2]
HK(IFRIC) - INT 7	Applying the restatement approach under HKAS 29 "Financial Reporting in Hyperinflationary Economies" [3]
HK(IFRIC) - INT 8	Scope of HKFRS 2 [4]
HK(IFRIC) - INT 9	Reassessment of embedded derivatives [5]
HK(IFRIC) - INT 10	Interim financial reporting and impairment [6]
HK(IFRIC) - INT 11	HKFRS 2: Group and Treasury Share Transactions [7]
HK(IFRIC) - INT 12	Service Concession Arrangements [8]

1 *Effective for annual periods beginning on or after 1 January 2007.*
2 *Effective for annual periods beginning on or after 1 January 2009.*
3 *Effective for annual periods beginning on or after 1 March 2006.*
4 *Effective for annual periods beginning on or after 1 May 2006.*
5 *Effective for annual periods beginning on or after 1 June 2006.*
6 *Effective for annual periods beginning on or after 1 November 2006.*
7 *Effective for annual periods beginning on or after 1 March 2007.*
8 *Effective for annual periods beginning on or after 1 January 2008.*

3. SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements have been prepared on the historical cost basis.

The consolidated financial statements have been prepared in accordance with Hong Kong Financial Reporting Standards 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. Control is achieved where the Company has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.

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

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

All intra-group transactions, balances, 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.

Interests in associates

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

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

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

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 (which includes any long-term interests that, in substance, form part of the Group's net investment in the 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.

3. SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Jointly controlled entities *(continued)*

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 and represents amounts receivable for goods and services provided in the normal course of business, net of discounts and sales related taxes.

Sales of good

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

Service income

Service income is recognised when services are provided.

Construction contracts

Revenue from construction contracts is recognised in accordance with the Group's accounting policy on construction contracts (see below).

Interest income

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

Construction contracts

Where the outcome of a construction contract can be estimated reliably, revenue and costs are recognised by reference to the stage of completion of the contract activity at the balance sheet date, as measured by the proportion that contract costs incurred for work performed to date bear to the estimated total contract costs. Variations in contract work, claims and incentive payments are included to the extent that they have been agreed with the customer.

Where the outcome of a construction contract cannot be estimated reliably, contract revenue is recognised to the extent of contract costs incurred that it is probable will be recoverable. Contract costs are recognised as expenses in the period in which they are incurred.

Where contract costs incurred to date plus recognised profits less recognised losses exceed progress billings, the surplus is shown as an amount due from customers for contract work. For contracts where progress billings exceed contract costs incurred to date plus recognised profits less recognised losses, the surplus is shown as an amount due to customers for contract work. Amounts received before the related work is performed are included in the consolidated balance sheet, as a liability, as advances received. Amounts billed for work performed but not yet paid by the customer are included in the consolidated balance sheet under trade and other receivables.

Leasing

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

The Group as lessor

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

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

Foreign currencies

In preparing the financial statements of each individual group entity, transactions in currencies other than the entity's functional currency (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 exchange prevailing on the dates of the transactions. At each balance sheet date, monetary items denominated in foreign currencies are retranslated at the rates prevailing on the balance sheet date. Non-monetary items that are measured in terms of historical cost in a foreign currency are not retranslated.

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

Borrowing costs

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

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

Government grant

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 and are classified as other income.

Retirement benefit costs

Payments to state-managed retirement benefit schemes are charged as an expense when employees have rendered service entitling them to the contributions.

Taxation

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

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

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

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 the profit or loss, except when it relates to items charged or credited directly to equity, in which case the deferred tax is also dealt with in equity.

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

Property, plant and equipment

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

Construction-in-progress is stated at cost which includes all construction costs and other direct costs attributable to such projects including borrowing costs capitalised. Construction in progress is not depreciated until completion of construction and the asset is available for use. The cost of completed construction works is transferred to the appropriate category of property, plant and equipment.

Depreciation is provided to write off the cost of property, plant and equipment over their estimated useful lives and after taking into account of their estimated residual value.

Plant and machinery and furniture, fixtures and equipment are depreciated on reducing-balance method. Buildings and motor vehicles are depreciated on a straight-line method.

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 income statement in the year in which the item is derecognised.

Investment properties

On initial recognition, investment properties are measured at cost, including any directly attributable expenditure. Subsequent to initial recognition, investment properties are stated at cost less subsequent accumulated depreciation and any accumulated impairment losses. Depreciation is charged so as to write off the cost of investment properties using the straight-line method.

An investment property is derecognised upon disposal or when the investment property is permanently withdrawn from use or no future economic benefits are expected from its disposals. 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 asset) is included in the consolidated income statement in the year in which the item is derecognised.

Prepaid lease payments

The prepayment made on acquiring land use right represents prepaid lease payment and it is accounted for as an operating lease. The prepaid lease payment is realised to consolidated income statement on a straight-line basis over the lease term, or when there is impairment, the impairment is expensed in the consolidated income statement.

Research and development expenditure

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

Intangible assets

Intangible assets acquired separately

Intangible assets acquired separately and 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.

Gains or losses arising from derecognition of an intangible asset are measured at the difference between the net disposal proceeds and the carrying amount of the asset and are recognised in the consolidated income statement when the asset is derecognised.

3. SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Intangible assets *(continued)*

Impairment

Intangible assets with finite useful lives are tested for impairment when there is an indication that an asset may be impaired (see the accounting policies in respect of impairment losses for tangible and intangible assets below).

Inventories

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

Financial instruments

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

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 time frame 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 are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. At each balance sheet date subsequent to initial recognition, loans and receivables (including amount due from associates, trade and other receivables, amount due from customers for contract works, bank balances and pledged bank deposits) 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.

Available-for-sale financial assets

Available-for-sale financial assets are non-derivatives that are either designated or not classified as financial assets at fair value through profit or loss, loans and receivables or held-to-maturity investments.

Available-for-sale equity investments that do not have a quoted market price in an active market and whose fair value cannot be reliably measured are measured at cost less any identified impairment losses at each balance sheet date subsequent to initial recognition. 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.

3. SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Financial assets *(continued)*

Financial liabilities and equity

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

Financial liabilities

Financial liabilities including trade and other payables and borrowings are subsequently measured at amortised cost, using the effective interest method.

Equity instruments

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

Impairment losses

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 any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). Where it is not possible to estimate the recoverable amount of an individual asset, the Group estimates the recoverable amount of the cash-generating unit to which the asset belongs. Where a reasonable and consistent basis of allocation can be identified, corporate assets are also allocated to individual cash-generating units, or otherwise they are allocated to the smallest group of cash-generating units for which a reasonable and consistent allocation basis can be identified.

Recoverable amount is the higher of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset for which the estimates of future cash flows have not been adjusted.

If the recoverable amount of an asset (or cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (cash-generating unit) is reduced to its recoverable amount. An impairment loss is recognised immediately in profit or loss, unless the relevant asset is carried at a revalued amount, in which case the impairment loss is treated as a revaluation decrease.

Where an impairment loss subsequently reverses, the carrying amount of the asset (cash-generating unit) 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 (cash-generating unit) in prior years. Impairment loss is recognised immediately in profit or loss.

Derecognition

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

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

Provisions

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

4. KEY SOURCES OF ESTIMATION UNCERTAINTY

In the process of applying the Group's accounting policies, management makes various estimates and judgements (other than those involving estimates) based on past experience, expectations of the future and other information. The key source of estimation uncertainty and the critical judgement that can significantly affect the amounts recognised in the financial information is discussed below.

Allowance for bad and doubtful debts

The Group performs ongoing credit evaluations of its customers and adjust credit limits based on payment history and the customer's current credit-worthiness, as determined by the review of their current credit information. The Group continuously monitors collections and payments from its customers and maintains a provision for estimated credit losses. The amount of provision is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate (i.e. the effective interest rate computed at initial recognition) based upon its historical experience and any specific customer collection issues that it has been identified. Credit losses have historically been within the Group's expectations and the Group will continue to monitor the collections from customers and maintain an appropriate level of estimated credit losses.

Provision

Provision has been made for additional costs to repair or replace defective goods, such as labour (whether internal or external) and material costs, and cost that might not be recovered from customers for rework. The provision requires management to estimate the extend of repairment and replacments with reference to historical warranty trends and may vary as a result of new materials and altered manufacturing proceeds. Any of these factors may affect the extent of the repairement or replacement required and therefore the ultimate repair and replacement costs to be incurred in the future period.

5. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES

The Group's major financial instruments include trade and other receivables, amount due from customers for contract works, bank balances, pledged bank deposit, borrowings and trade and other 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.

Credit risk

The Group's maximum exposure to credit risk in the event of the counterparties failure to perform their obligations as at 31 December 2006 in relation to each class of recognised financial assets is the carrying amount of those assets 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.

The Group has no significant concentration of credit risk, with exposure spread over a number of counterparties and customers.

The credit risk relating to bank balances, bank deposits and pledged bank deposits is limited because the counterparties are banks with high credit ratings.

The Group has concentration of credit risk by geographical market as all sales are made in the PRC.

5. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES *(continued)*

Fair value interest rate risk

The Group's fair value interest rate risk relates primarily to fixed-rate bank deposits with maturity over three months (see Note 27 for details of the deposits). The Group currently does not have an interest rate hedging policy as the directors consider the interest rate fluctuation is not significant and will consider hedging significant interest rate exposure should the need arises.

Cash flow interest rate risk

The Group's cash flow interest rate risk relates primarily to variable-rate bank deposits. It is the Group's policy to keep its bank deposits at floating rate of interests so as to minimise the fair value interest rate risk.

Fair value

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

6. REVENUE AND SEGMENT INFORMATION

Revenue represents the amounts received and receivable for goods sold and services rendered by the Group to outside customers during the year and is analysed as follows:

	2006	2005
	RMB'000	*RMB'000*
Sales of goods	**2,308,715**	1,566,681
Revenue from construction contracts	**2,329,661**	1,335,723
Revenue from other services	**59,703**	145,454
	4,698,079	3,047,858

Business segments

The Group operates in three major segments as follows – main thermal power equipment, main hydro power equipment, AC/DC motors and engineering and repairing services for power stations.

Principal activities are as follows:

Main thermal power equipment	manufacture and sale of main thermal power equipment.
Main hydro power equipment	manufacture and sale of main hydro power equipment.
Others	manufacture and sale of AC/DC motors, providing engineering and repairing services for power stations

6. REVENUE AND SEGMENT INFORMATION *(continued)*

2006

	Main thermal power equipment *RMB'000*	Main hydro power equipment *RMB'000*	Others *RMB'000*	Eliminations *RMB'000*	Consolidated *RMB'000*
Revenue					
External sales	2,367,417	2,153,957	176,705	—	4,698,079
Inter-segment sales	—	—	429,393	(429,393)	—
Total revenue	2,367,417	2,153,957	606,098	(429,393)	4,698,079
SEGMENT RESULTS	941,512	328,965	42,707	—	1,313,184
Other income					179,864
Distribution expenses					(30,025)
Administrative expenses					(503,409)
Finance costs					(314)
Profit before taxation					959,300
Income tax expense					(94,244)
Profit for the year					865,056
ASSETS					
Segment assets	1,548,000	886,987	144,014		2,579,001
Unallocated corporate assets					7,051,472
Consolidated total assets					9,630,473
LIABILITIES					
Segment liabilities	3,257,732	2,076,969	80,328		5,415,029
Unallocated corporate liabilities					1,875,674
Consolidated total liabilities					7,290,703
OTHER INFORMATION					
Allowance for bad and doubtful debts	23,555	13,604	7,655		44,814

6. REVENUE AND SEGMENT INFORMATION *(continued)*

2005

	Main thermal power equipment *RMB'000*	Main hydro power equipment *RMB'000*	Others *RMB'000*	Eliminations *RMB'000*	Consolidated *RMB'000*
External sales	1,439,963	1,335,723	272,172	—	3,047,858
Inter-segment sales	—	—	471,541	(471,541)	—
Total revenue	1,439,963	1,335,723	743,713	(471,541)	3,047,858
SEGMENT RESULTS	603,293	224,174	125,810	—	953,277
Other income					126,774
Distribution expenses					(20,989)
Administrative expenses					(440,589)
Finance costs					(1,272)
Profit before tax					617,201
Income tax expense					(82,213)
Profit for the year					534,988
ASSETS					
Segment assets	1,052,324	543,004	27,899		1,623,227
Unallocated corporate assets					6,839,661
Consolidated total assets					8,462,888
LIABILITIES					
Segment liabilities	3,377,145	1,984,586	64,454		5,426,185
Unallocated corporate liabilities					1,336,974
Consolidated total liabilities					6,763,159
OTHER INFORMATION					
Allowance for bad and doubtful debts	5,237	3,866	2,585		11,688

Geographical segments

All of the Group's sales and provision of services are in the PRC and all of the Group's carrying amount of segment assets and additions to property, plant and equipment are situated in the PRC. Accordingly, no segmental analysis of geographical segments is presented for both years.

7. OTHER INCOME

	2006	2005
	RMB'000	*RMB'000*
Interest income	**63,464**	47,036
Consultancy service income	**16,041**	—
Government grants *(Note 32)*	**42,524**	6,664
Sale of scrap materials	**46,425**	57,575
Rental income	**370**	462
Recovery of bad debts	**—**	6,627
Gain on disposal of property, plant and equipment	**1,191**	—
Provision of power supply	**6,461**	5,757
Others	**3,388**	2,653
	179,864	126,774

8. FINANCE COSTS

	2006	2005
	RMB'000	*RMB'000*
Bank loans and other borrowings wholly repayable within five years	**314**	1,836
Less: amount capitalised	**—**	(564)
	314	1,272

Borrowing cost capitalised during the year ended 31 December 2005 was calculated by applying a capitalisation rate of 4.53% to expenditure on qualifying assets.

9. INCOME TAX EXPENSE

	2006	2005
	RMB'000	*RMB'000*
PRC enterprise income tax		
— Current year	**141,509**	82,213
— Underprovision in prior years	**1,551**	—
	143,060	82,213
Current year deferred tax *(Note 22)*	**(48,816)**	—
	94,244	82,213

The charge mainly represents PRC enterprise income tax calculated at 15% of the estimated taxable income for the year.

9. INCOME TAX EXPENSE *(continued)*

The tax charge for the year can be reconciled to the profit before tax per the consolidated income statement as follows:

	2006	2005
	RMB'000	*RMB'000*
Profit before tax	**959,300**	617,201
Tax charge at enterprise tax rate of 15% (2005: 15%)	**143,895**	92,580
Tax effect of income not taxable for tax purpose	**(12,453)**	(22,777)
Tax effect of expenses not deductible for tax purpose	**5,504**	10,017
Tax effect of tax benefits *(note)*	**(16,897)**	—
Utilisation of temporary differences previously not recognised	**(27,702)**	—
Utilisation of tax losses previously not recognised	**—**	(3,315)
Underprovision in respect of prior years	**1,551**	—
Effect of different tax rates of subsidiaries operating under other statutory income tax rates	**346**	5,708
Tax charge for the year	**94,244**	82,213

Pursuant to a document issued by the State Tax Bureau of the PRC on 23 February 1994, taxable income earned by the Group, except for certain subsidiaries, is subject to an enterprise income tax of 15%.

Note: Tax benefits represents (i) an incentive scheme, in addition to the research and development cost which is deductible for tax purpose, further 50% of the research and development cost is deductible (ii) tax credits on acquisition of qualified property, plant and equipment.

10. PROFIT FOR THE YEAR

	2006	2005
	RMB'000	*RMB'000*
Profit for the year has been arrived at after charging (crediting):		
Salaries and wages	**415,000**	359,042
Retirement benefits scheme contributions		
— defined contribution plans *(Note 36)*	**55,699**	47,621
Staff welfare	**60,215**	43,175
Housing fund *(Note 36)*	**39,595**	25,732
Termination benefits	**7,977**	—
Total staff cost *(Note a)*	**578,486**	475,570
Auditor's remuneration	**1,180**	1,070
Amortisation of intangible assets included in administrative expenses	**670**	933
Allowance for bad and doubtful debts	**44,814**	11,688
Cost of inventories recognised as an expense	**3,384,895**	2,094,581
Operating lease rentals in respect of prepaid lease payments	**713**	713
Depreciation on property, plant and equipment	**104,119**	95,494
Depreciation on investment properties	**1,112**	1,112
(Gain) loss on disposals of property, plant and equipment	**(1,191)**	2,380
Loss on disposal of an associate	**—**	43
Reversals of allowance for bad and doubtful debts	**—**	(473)
Reversal of impairment loss of property, plant and equipment *(Note b)*	**(1,161)**	—
Reversal of write down for inventories *(Note c)*	**(845)**	(2,597)
Rental expense	**3,596**	3,648
Written off of inventories	**5,669**	656
Foreign exchange losses	**24,734**	17,580
Foreign exchange gains	**(18,133)**	(6,928)
Research and development cost	**151,633**	80,535
Gross rental income from investment properties	**(392)**	(489)
Less: direct operating expenses from investment properties that generated rental income during the year	**22**	27
	(370)	(462)

Note: (a) *Directors' and supervisors' emoluments are included in the above staff costs.*

(b) *Reversal of impairment loss of property, plant and equipment was made when the recoverable amount of those property, plant and equipment on which impairment had previously been made is estimated to be greater than its carrying amount.*

(c) *Reversal of write down for inventories was made when the net realisable value of those inventories on which allowance had previously been made is greater than cost.*

11. DIRECTORS' AND SUPERVISORS' EMOLUMENTS

The emoluments paid or payable to each of the 12 (2005: 19) directors and supervisors were as follows:

For the year ended 31 December 2006

	Director						Independent non-executive directors			Supervisors			
	Zhu Yuanchao RMB'000	Han Zhiqiao RMB'000	Li Hongdong RMB'000	Gong Dan RMB'000	Fu Haibo* RMB'000	Liu Shigang* RMB'000	Chen Zhangwu RMB'000	Xie Songlin RMB'000	Zheng Peimin RMB'000	Wen Bingyou* RMB'000	Wang Wanling RMB'000	Fang Yunfu RMB'000	Total RMB'000
Fees	—	—	—	—	—	—	50	50	50	—	—	—	150
Basic salaries and allowances	348	348	296	296	—	—	—	—	—	—	105	126	1,519
Retirement benefits scheme contributions	24	24	20	20	—	—	—	—	—	—	4	4	96
Total	372	372	316	316	—	—	50	50	50	—	109	130	1,765

For the year ended 31 December 2005

	Director										Independent non-executive directors				Supervisors					
	Zhu Yuanchao RMB'000	Han Zhiqiao RMB'000	Zhang Tiande RMB'000	Li Hongdong RMB'000	Gong Dan RMB'000	He Jianhua RMB'000	Gao Feng RMB'000	Liu Hui RMB'000	Fu Haibo* RMB'000	Liu Shigang* RMB'000	Jing Jiachuan RMB'000	Chen Zhangwu RMB'000	Xie Songlin RMB'000	Zheng Peimin RMB'000	Zhou Xiaomin RMB'000	Xiao Shuiquan RMB'000	Wen Bingyou* RMB'000	Wang Wanling* RMB'000	Fang Yunfu* RMB'000	Total RMB'000
Fees	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—
Basic salaries and allowances	175	175	129	129	129	129	65	129	—	—	65	30	30	30	23	26	—	—	—	1,264
Bonus	—	—	—	—	—	—	—	—	—	—	—	—	—	—	68	70	—	—	—	138
Retirement benefits scheme contributions	10	10	20	20	20	20	20	20	—	—	20	—	—	—	12	13	—	—	—	185
Total	185	185	149	149	149	149	85	149	—	—	85	30	30	30	103	109	—	—	—	1,587

* *Emoluments paid by DEC.*

None of the directors received more than HK$1,000,000 for any of these two years. No directors waived any emoluments for these two years.

The five highest paid individuals in the Group in 2006 and 2005 were all directors of the Company and details of their emoluments are included above. During the year, no remuneration was paid by the Group to the directors or the five highest paid individuals as an inducement to join or upon joining the Group or as compensation for loss of office. None of the directors has waived or agreed to waive any remunerations for these two years ended.

12. DIVIDENDS

	2006	2005
	RMB'000	*RMB'000*
Dividends recognised as distribution during the year:		
2005 Final dividend of RMB0.5 (2004: RMB0.12) per ordinary share	**225,000**	54,000

The final dividend of RMB0.2 (2005: RMB0.5) per share has been proposed by the directors and is subject to approval by the shareholders in general meeting.

13. EARNINGS PER SHARE

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

Earnings

	2006	2005
	RMB'000	*RMB'000*
Earnings for the purposes of basic and diluted earnings per share (profit for the year attributable to shareholders of the parent)	864,708	534,698

Number of shares

	2006	2005
	'000	*'000*
Weighted average number of ordinary shares for the purposes of basic and diluted earnings per share	450,000	450,000

No diluted earnings per share are calculated as there were no potentially dilutive share is issued in both periods presented.

14. PROPERTY, PLANT AND EQUIPMENT

	Buildings	Plant and machinery	Furniture, fixtures and equipment	Motor vehicles	Total
	RMB'000	*RMB'000*	*RMB'000*	*RMB'000*	*RMB'000*
COST					
At 1 January 2005 (as previously stated)	339,345	684,270	82,975	9,236	1,115,826
Prior period adjustment *(note a)*	(48,624)	—	—	—	(48,624)
As restated	290,721	684,270	82,975	9,236	1,067,202
Reclassification	—	(29)	29	—	—
Transfer from construction in progress	24,888	110,680	6,250	3,541	145,359
Additions	57	2,566	3,669	694	6,986
Disposals/written off	(2,502)	(8,408)	(11,571)	(1,155)	(23,636)
At 31 December 2005	313,164	789,079	81,352	12,316	1,195,911
Transfer from construction in progress	98,558	119,593	7,788	2,057	227,996
Additions	—	952	447	—	1,399
Disposals/written off	(6,387)	(8,943)	(5,055)	(1,529)	(21,914)
At 31 December 2006	405,335	900,681	84,532	12,844	1,403,392
ACCUMULATED DEPRECIATION AND IMPAIRMENT					
At 1 January 2005 (as previously stated)	147,511	379,922	65,337	6,504	599,274
Prior period adjustment *(note a)*	(20,371)	—	—	—	(20,371)
As restated	127,140	379,922	65,337	6,504	578,903
Charge for the year	14,573	74,999	4,885	1,037	95,494
Eliminated on disposals/ written off	(486)	(7,762)	(11,001)	(1,130)	(20,379)
At 31 December 2005	141,227	447,159	59,221	6,411	654,018
Charge for the year	14,524	79,386	8,877	1,332	104,119
Eliminated on disposals/ written off	(5,051)	(7,568)	(4,837)	(1,362)	(18,818)
Reversal of impairment loss recognised	—	(1,161)	—	—	(1,161)
At 31 December 2006	150,700	517,816	63,261	6,381	738,158
NET BOOK VALUES					
At 31 December 2006	254,635	382,865	21,271	6,463	665,234
At 31 December 2005	171,937	341,920	22,131	5,905	541,893

The buildings are held under medium term leases and are situated in the PRC.

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

As at 31 December 2006, the Group has not obtained the building ownership certificates for certain buildings with net book value of approximately RMB206,629,000 (2005: RMB127,117,000). All the buildings are located in the PRC.

Note a: Two properties stationed in Sichuan and Beijing, the PRC, were transferred to the Group in 2004 for settlement of certain other receivables. The properties were intended for rental and capital appreciation purpose. However, the properties were classified as property, plant and equipment since 2004. As a result, prior year adjustment has been made to the consolidated balance sheet to reclassify these properties as investment properties as at 1 January 2005 (see Note 17). This reclassification has no impact on the result of the Group for the current and prior year.

	Useful lives	Estimated residual value ratio	Annual depreciation rate
Buildings for production	20	5%	4.75%
Buildings for non-production	25	5%	3.80%
Plant and machinery	10	5%	Declining-balance method
Furniture, fixtures and equipment	5 - 6	5%	Declining-balance method
Motor vehicles	6	5%	15.83%

15. CONSTRUCTION IN PROGRESS

	2006	2005
	RMB'000	*RMB'000*
COST		
As at 1 January	**151,654**	124,310
Additions	**125,994**	172,157
Capitalisation of interest expenses	**—**	564
	277,648	297,031
Written off	**—**	(18)
Transfer to property, plant and equipment	**(227,996)**	(145,359)
As at 31 December	**49,652**	151,654

16. PREPAID LEASE PAYMENTS

The Group's prepaid lease payments represent medium-term land use rights in the PRC. They are analysed for reporting purpose as follow:

	2006	2005
	RMB'000	*RMB'000*
Analysed for reporting purposes as:		
Current portion	**1,148**	713
Non-current portion	**27,745**	26,363
	28,893	27,076

17. INVESTMENT PROPERTIES

	RMB'000
COST	
At 1 January 2005 (as previously stated)	—
Transfer from property, plant and equipment *(Note 14)*	28,253
At 1 January 2005 (as restated), 31 December 2005 and 2006	28,253
ACCUMULATED DEPRECIATION	
At 1 January 2005	—
Provided for the year	1,112
At 31 December 2005	1,112
Provided for the year	1,112
At 31 December 2006	2,224
CARRYING VALUES	
At 31 December 2006	26,029
At 31 December 2005	27,141

The fair value of the Group's investment properties at 31 December 2006 and 31 December 2005 was RMB36,530,000 (2005: RMB35,370,000). The fair value has been arrived at based on a valuation carried out by Vigers Asia Pacific Ltd., an independent valuer not connected with the Group. The valuation, which conforms to International Valuation Standards, was determined by reference to recent market prices for similar properties.

At 31 December 2006, the Group has not obtained the building ownership certificates for certain investment properties with net book value of approximately RMB23,739,000 (2005: RMB24,754,000).

The above investment properties are depreciated on a straight-line basis over 25 years.

18. INTANGIBLE ASSETS

	Technology know-how *RMB'000*	Computer software and telecommunication system *RMB'000*	Total *RMB'000*
COST			
At 1 January 2005	2,556	2,099	4,655
Additions	—	54	54
At 31 December 2005	2,556	2,153	4,709
Additions	—	1,283	1,283
At 31 December 2006	2,556	3,436	5,992
AMORTISATION			
At 1 January 2005	1,917	432	2,349
Charge for the year	511	422	933
At 31 December 2005	2,428	854	3,282
Charge for the year	128	542	670
At 31 December 2006	2,556	1,396	3,952
CARRYING VALUES			
At 31 December 2006	—	2,040	2,040
At 31 December 2005	128	1,299	1,427

All of the Group's intangible assets were acquired from third parties. The above intangible assets have definite useful lives and are amortised on a straight-line basis over 3 to 10 years pursuant to the corresponding license periods.

19. INTERESTS IN AN ASSOCIATE

	2006 ***RMB'000***	2005 *RMB'000*
Cost of investment in an associate unlisted in the PRC	**490**	490
Share of post-acquisition losses	**(490)**	(490)
	—	—

As at 31 December 2006, the Group had interests in the following associate:

Name of entity	Form of business structure	Place of incorporation and operation	Class of share held	Registered capital held by the Group %	Proporation of voting power held %	Principal activity
Leshan City Dongle Heavy Piece Handling Co., Ltd.	Limited liability	PRC	Registered capital	49	49	Provision of transportation and warehousing services

19. INTERESTS IN AN ASSOCIATE *(continued)*

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

	2006 *RMB'000*	2005 *RMB'000*
Total assets	**10,309**	11,196
Total liabilities	**(10,792)**	(11,139)
Net (liabilities) assets	**(483)**	57
Revenue	**7,583**	8,603
(Loss) profit for the year	**(540)**	377
Group's share of result of an associate for the year	**—**	—

The Group has discontinued recognition of its share of result of the associate. The amounts of unrecognised share of those associates, extracted from the relevant management accounts of the associates, both for the year and cumulatively, are as follows:

	2006 *RMB'000*	2005 *RMB'000*
Unrecognised share of losses of an associate for the year	**(265)**	—
Accumulated unrecognised share of losses of an associate	**(265)**	—

20. INTERESTS IN A JOINTLY CONTROLLED ENTITY

	2006 *RMB'000*	2005 *RMB'000*
Cost of unlisted investments in jointly controlled entity	**23,375**	6,375
Share of post-acquisition profits	**—**	—
	23,375	6,375

As at 31 December 2006, the Group had interests in the following significant jointly controlled entity:

Name of entity	Form of business structure	Place of incorporation and operation	Class of share held	Registered capital held by the Group %	Proportion of voting power held %	Principal activity
Areva-Dongfang Reactor Coolant Pumps Company Limited	Limited liability	PRC	Registered capital	50	50	Design, manufacture and sales of reactor coolant pumps for unclear power Stations.

This jointly controlled entity has not commenced business in 2006.

20. INTERESTS IN A JOINTLY CONTROLLED ENTITY *(continued)*

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

	2006	2005
	RMB'000	*RMB'000*
Current assets	**18,528**	6,450
Non-current assets	**13,388**	238
Current liabilities	**7,314**	313
Non-current liabilities	**1,227**	—
Income	**—**	—
Expenses	**—**	—

21. AVAILABLE-FOR-SALE INVESTMENTS

	2006	2005
	RMB'000	*RMB'000*
Unlisted equity securities, at cost	**1,810**	1,810
Less: impairment losses recognised	**(311)**	(311)
	1,499	1,499

The above unlisted investments represent investments in unlisted equity securities issued by private entities incorporated in the PRC. They are measured at cost less impairment at each balance sheet date because the range of reasonable fair value estimates is so wide that the directors of the Company are of the opinion that their fair values cannot be measured reliably.

22. DEFERRED TAX ASSETS

The following are the major deferred tax balances recognised and movements thereon during the current year:

	Trade and other payables	**Trade and other receivables**	**Provisions**	**Inventories**	**Total**
	RMB'000	*RMB'000*	*RMB'000*	*RMB'000*	*RMB'000*
Deferred tax asset					
At 1 January 2005 and 1 January 2006	—	—	—	—	—
Credit to consolidated income statement	20,995	20,107	7,364	350	48,816
At 31 December 2006	20,995	20,107	7,364	350	48,816

As at 31 December 2005, the Group had deferred tax assets arising from temporary differences of RMB29,147,000 which had not been recognised in the consolidated financial statements due to the unpredictability of future profit streams.

23. INVENTORIES

	2006	2005
	RMB'000	*RMB'000*
Raw materials and consumables	**1,133,966**	898,543
Work in progress	**954,359**	534,404
Finished goods	**332,558**	361,076
	2,420,883	1,794,023

24. AMOUNT DUE FROM AN ASSOCIATE

The amount due from an associate represented an advance and is unsecured, interest free and recoverable within twelve months from the balance sheet date. The directors consider its fair value approximates the carrying amount.

25. TRADE AND OTHER RECEIVABLES

	2006	2005
	RMB'000	*RMB'000*
Trade receivables	**1,225,012**	979,336
Less: accumulated impairment	**(153,136)**	(108,322)
	1,071,876	871,014
Prepayment, deposits and other receivables	**1,444,269**	752,520
	2,516,145	1,623,534

The Group offers credit terms generally accepted in the power equipment manufacturing industry of two to three years to its customers, which vary on the size of contract, credibility and reputation of the customers. In order to manage the credit risks associated with trade receivables effectively, credit of customers are evaluated periodically.

The following is an aged analysis of trade receivables net of impairment losses at the reporting date:

	2006	2005
	RMB'000	*RMB'000*
Within 1 year	**715,795**	593,863
1 - 2 years	**239,506**	176,443
2 - 3 years	**87,264**	69,625
More than 3 years	**29,311**	31,083
	1,071,876	871,014

The directors consider the fair value of the Group's trade receivables and other receivable at 31 December 2006 and 31 December 2005 approximates the corresponding carrying amount.

Included in the trade receivables is bills receivables amounted to RMB45,930,000 (2005: RMB18,629,000) aged within 1 year.

Included in the trade receivables is retentions held by customers for contract works amounted to RMB758,670,143 (2005: RMB481,453,732), which represented the net of impairment losses of RMB30,671,019 (2005: nil).

26. AMOUNTS DUE FROM (TO) CUSTOMERS FOR CONTRACT WORK

	2006	2005
	RMB'000	*RMB'000*
Contracts in progress at the balance sheet date		
Contract costs incurred	**1,714,945**	897,471
Recognised profits less recognised losses	**320,650**	160,387
	2,035,595	1,057,858
Less: progress billings	**(3,437,635)**	(2,633,756)
	(1,402,040)	(1,575,898)
Analysed for reporting purposes as:		
Amounts due from contract customers	**569,812**	259,869
Amounts due to contract customers	**(1,971,852)**	(1,835,767)
	(1,402,040)	(1,575,898)

The directors consider the fair value of the Group's amounts due from contract customers at 31 December 2006 and 31 December 2005 approximates the corresponding carrying amount.

27. PLEDGED BANK DEPOSITS/ BANK BALANCES

Pledged bank deposits represents deposits pledged for short-term bank loans facilities granted to the Group and are therefore classified as current assets.

As at 31 December 2006, included in the bank balances is approximately RMB1,215,341,000 (2005: RMB1,957,009,000) bank deposits with maturity over three months.

The weighted average effective interest rates on bank deposits and pledged bank deposits as at 31 December 2006 were 0.72% (2005: 0.72%) and ranged from 2.25% to 3.6% (2005: 2.2% to 3.5%) respectively.

The directors consider that the carrying amounts approximates their fair values.

28. TRADE PAYABLES AND OTHER PAYABLES

The following is an aged analysis of the Group's trade payables at the balance sheet date:

	2006	2005
	RMB'000	*RMB'000*
Within 1 year	**892,179**	672,877
1 - 2 years	**53,020**	12,730
2 - 3 years	**8,964**	692
More than 3 years	**820**	1,220
	954,983	687,519
Other payables and accruals	**3,932,452**	3,967,842
	4,887,435	4,655,361

The fair value of the Group's trade payables and other payables at 31 December 2006 and 31 December 2005 approximates the corresponding carrying amount.

Included in the trade payables is bills payables amounted to RMB315,298,000 (2005: RMB237,321,000) aged within 1 year.

29. OTHER TAX LIABILITIES

	2006	2005
	RMB'000	*RMB'000*
Value added tax	**64,824**	36,999
Business tax	**725**	811
Others	**7,515**	1,004
	73,064	38,814

30. BORROWINGS

	2006	2005
	RMB'000	*RMB'000*
Unsecured bank loans repayable within one year	**—**	10,000

The Group's borrowings as at 31 December 2005 carried at fixed rate of 5.022%. The directors consider that the carrying amounts of the borrowings approximate their fair value.

31. PROVISIONS

	RMB'000
Warranty	
At 1 January 2005 and 1 January 2006	—
Provided for the year	38,045
At 31 December 2006	38,045

The provision for warranty claims represents the present value of the director's best estimate of the future outflow of economic benefits that will be required under the Group's warranty program for power equipment for two to three years. The estimate has been made on the basis of historical warranty trends and may vary as a result of new materials and altered manufacturing processes.

32. DEFERRED INCOME

Deferred income represents government grants received for acquisition and improvement of property, plant and equipment.

The deferred income is released to the income statement over the expected useful life of the relevant assets. Movements of deferred income during the year are as follows:

	2006	2005
	RMB'000	*RMB'000*
At 1 January	**135,761**	53,141
Additions	**76,642**	89,284
Realised to consolidated income statement	**(42,524)**	(6,664)
At 31 December	**169,879**	135,761
Analysed for reporting purposes as:		
Current portion	**29,842**	22,063
Non-current portion	**140,037**	113,698
	169,879	135,761

33. SHARE CAPITAL

	Number of shares		
	31 December 2005 *'000*	**Transfer** *'000*	**31 December 2006** *'000*
Authorised, issued and fully paid:			
Non-circulating state-owned domestic shares	220,000	(220,000)	—
Restricted circulating state-owned domestic shares	—	203,800	203,800
A shares	60,000	16,200	76,200
H shares	170,000	—	170,000
	450,000	—	450,000

	Share capital		
	31 December 2005 *RMB'000*	**Transfer** *RMB'000*	**31 December 2006** *RMB'000*
Non-circulating state-owned domestic shares	220,000	(220,000)	—
Restricted circulating state-owned domestic shares	—	203,800	203,800
A shares	60,000	16,200	76,200
H shares	170,000	—	170,000
	450,000	—	450,000

On 17 February 2006, the Company received a Transfer and Registration Confirmation issued by the China Securities Depository and Clearing Corporation Limited (Shanghai Branch) confirming that the 220,000,000 state-owned legal person shares of the Company have been transferred into the securities account of DEC.

On 17 April 2006, DEC made a share segregation reform (the "Reform Proposal"), that 2.7 non-circulating state-owned legal person shares ("Non-circulating Shares") would be allocated to each shareholders of A Shares for every 10 A Shares held by such A Shares shareholder at the close of business on the Reform Proposal record date, in exchange for the consent of A Shares shareholders on the conversion of its Non-circulating Shares into restricted circulating state-owned domestic shares and A Shares. Accordingly, an aggregate of 16,200,000 shares were allocated by DEC to the A Shares shareholders.

33. SHARE CAPITAL *(continued)*

	Number of shares		
	31 December 2005 *'000*	**Transfer** *'000*	**31 December 2006** *'000*
Authorised, issued and fully paid:			
Non-circulating state-owned domestic shares	220,000	—	220,000
A shares	60,000	—	60,000
H shares	170,000	—	170,000
	450,000	—	450,000

	Share capital		
	31 December 2005 *RMB'000*	**Transfer** *RMB'000*	**31 December 2006** *RMB'000*
Non-circulating state-owned domestic shares	220,000	—	220,000
A shares	60,000	—	60,000
H shares	170,000	—	170,000
	450,000	—	450,000

34. OPERATING LEASE ARRANGEMENTS

The Group as lessor

The inventory properties of the Group are expected to generate rental yields of 3.13% on an ongoing basis.

At balance sheet date, the Group had contracted with tenants for the following future minimum lease payments.

	2006 *RMB'000*	2005 *RMB'000*
Within one year	**528**	200
In the second year	**119**	135
	647	335

35. CAPITAL COMMITMENTS

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

	2006	2005
	RMB'000	*RMB'000*
Capital expenditure for the acquisition of:		
Investment in a jointly controlled entity *(Note 20)*		
— contracted for but not provided in the consolidated financial statements	**19,125**	36,125
Construction in progress		
— contracted for but not provided in the consolidated financial statements	**99,226**	123,507
	118,351	159,632

36. RETIREMENT BENEFITS PLANS, HEALTH CARE ASSURANCE AND HOUSING FUND

The employees of the Group are members of a state-managed retirement benefit scheme operated by the local government. The Company is required to contribute a specified percentage of their payroll costs to the retirement benefit scheme to fund the benefits. The only obligation of the Company with respect to the retirement benefit scheme is to make the specified contributions. For the year ended 31 December 2006, the retirement benefits scheme contributions made by the Group amounted to RMB55,699,000 (2005: RMB47,621,000).

The Group also carried out a defined contribution health care scheme. Under this scheme, the Group is required to make annual contributions to the health care scheme on 7% of employees' salaries. The maximum amount of reimbursed medical expenses for each staff is RMB34,000 per annum. For the year ended 31 December 2006, the health care scheme contributions made by the Group amounted to RMB13,943,000 (2005: RMB8,423,000).

The Group's full-time employees are entitled to a housing fund. The fund can be used by the employees to purchase housing, or claimed upon their retirement. The Group is required to make annual contributions to the housing fund on 11% of employees' salaries. From 1 February 2005, the contribution rate was changed to 15%. For the year ended 31 December 2006, the housing fund contributions made by the Group amounted to RMB39,595,000 (2005: RMB25,732,000).

37. RELATED PARTY TRANSACTIONS

During the year, the Group entered into the following transactions with related parties:

(a) Transaction with DEC and its subsidiaries (other than DFEW and its subsidiaries in Note (b))

	2006	2005
	RMB'000	*RMB'000*
Expenditure		
— Interest paid and payable	**—**	897
Revenue		
— Sales of finished goods	**418,490**	187,696
Other income		
— Interest income	**5,319**	1,118
— Others	**3,281**	403
	8,600	1,521

(b) Transactions with DFEW and its subsidiaries

	2006	2005
	RMB'000	*RMB'000*
Expenditure		
— Purchase of raw materials	**111,858**	119,651
— Freight and maintenance	**73,116**	63,031
— Rental expenses	**3,596**	3,648
— Sub-contracting services	**36,003**	9,222
— Management fee	**—**	5,830
— Others	**5,644**	4,280
	230,217	205,662
Other income		
— Provision of power supply	**6,461**	5,757
— Proceeds on sales of raw materials and finished goods	**41,644**	47,562
— Proceeds from disposal of interest in an associate	**—**	70
— Others	**203**	5,722
	48,308	59,111

37. RELATED PARTY TRANSACTIONS *(continued)*

(c) Current accounts with related parties are as follows

Name of related company	Related balances	2006 *RMB'000*	2005 *RMB'000*
DEC and its subsidiaries (other than DFEW and its subsidiaries below)	Trade receivables	**105,171**	111,105
	Receipts in advance	**484,184**	135,604
	Prepayment	**8,615**	—
	Trade payable	**1,759**	—
	Other payables	**201**	—
DEC Finance Company (subsidiary of DEC)	Deposits	**217,660**	35,800
DFEW and its subsidiaries	Trade receivables	**70,940**	45,518
	Other receivables	**16,748**	72
	Prepayment	**13,859**	5,068
	Trade payables	**73,641**	40,423
	Bills payables	**13,874**	3,157
	Receipts in advance	**2,919**	203
	Other payables	**5,198**	3,143

Balance with associate is unsecured, interest free and repayable on demand. Details of the balance with associate of the Group are set out in the consolidated balance sheet.

37. RELATED PARTY TRANSACTIONS *(continued)*

(d) Transactions/balances with other state-controlled entities in the PRC

The Group operates in an economic environment currently predominated by entities directly or indirectly owned or controlled by the PRC government ("state-controlled entities"). In addition, the Group itself is part of a larger group of companies under DEC, which is controlled by the PRC government. Apart from the transactions with DEC and its subsidiaries disclosed in (a), (b) and (c) above, the Group also conducts business with other state-controlled entities. The directors consider those state-controlled entities are independent third parties so far as the Group's business transactions with them are concerned. In establishing its pricing strategies and approval process for transactions with other state-controlled entities, the Group does not differentiate whether the counter-party is a state-controlled entity or not.

Material transactions/balances with other state controlled entities are as follows:

	2006	2005
	RMB'000	*RMB'000*
Sales	**4,522,735**	2,838,006
Purchases	**600,685**	467,664
Amounts due from other state-controlled entities	**1,038,609**	856,504
Amounts due to other state-controlled entities	**16,442**	13,086

(e) Compensation of key management personnel

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

	2006	2005
	RMB'000	*RMB'000*
Short-term benefits	**1,880**	1,591
Post-employment benefits	**239**	223
	2,119	1,814

The remuneration of directors and key executives is determined by the remuneration committee having regard to the performance of individuals and market trends.

The remuneration of two (2005: two) directors and one (2005: three) supervisors were paid by DEC.

38. PARTICULARS OF SUBSIDIARIES OF THE COMPANY

Name of subsidiary	Place/country of incorporation or registration/ operations	Class of share held	Paid up issued/ registered ordinary share capital	Proportion ownership interest held by the Company		Proportion of voting power held by the Company	Principal activities
				Directly	Indirectly		
			RMB'000	%	%		
DFEM Equipment Engineering Co., Ltd.	PRC	Registered capital	13,500	97.04	0.74	97.78	Provision of services for repair and upgrade of electrical machinery equipment
DFEM Power Equipment Co., Ltd.	PRC	Registered capital	42,754	98.83	—	98.83	Manufacture and sales of AC/DC electrical motors
DFEM Tooling and Moulding Co., Ltd.	PRC	Registered capital	14,600	99.32	—	99.32	Manufacture and sales of tools and moulds
DFEM Control Equipment Co., Ltd.	PRC	Registered capital	13,000	96.15	—	96.15	Manufacture and sales of control equipment of power generators

All of the subsidiaries of the Company are domestic entities. None of the subsidiaries had issued any debt securities at the end of the year.

39. POST BALANCE SHEET EVENT

On 4 January 2007, the board of directors of the Company convened the sixth meeting of the fifth session of the board to consider matters relating to the proposed non-public share issue in connection with the acquisition of assets by the Company from DEC, the controlling shareholder of the Company.

The Company proposes to acquire the shares in Dongfang Boiler Group Co., Ltd. ("Dongfang Boiler") that will be held by DEC after completion of the split share structure reform of Dongfang Boiler (representing approximately 68.05% of the total shares of Dongfang Boiler) from DEC. The Company also proposes to acquire the entire equity interest in Dongfang Turbine Co., Ltd. ("Dongfang Turbine") from DEC.

The total value of the shareholding of approximately 68.05% in Dongfang Boiler and the entire equity interest in Dongfang Turbine amounts to approximately RMB11.9 billion, but the actual purchase price for the purchase of these assets payable by the Company will be determined in accordance with the laws and regulations of the PRC and the results of the due diligence and independent audit of Dongfang Boiler and Dongfang Turbine, based on a valuation to be prepared by an asset valuer who holds securities practice qualification, market principles and prevailing pricing method and principles of fairness, and taking into account the interests of the minority shareholders of tradable shares.