

DIRECTORS' REPORT

1. Review of operations

(1) Overview operations

Year 2006 is the first year of the PRC's 11th 5-Year-Plan, in which, equipment manufacturing industry is emphasized and series policies and measures are come out to give manufacturers a new opportunity to develop. By taking advantages of this situation, the Company continues to improve its operation, and keeps fast development in the 5th year in a row. In 2006, the Company was on the right track and the management team led all the staff of the Company to work hard together, to participate in the market competition and grasped the opportunities firmly. After making great efforts, the Company has obtained good results in the operation. The followings were achieved in the year 2006:

- 1) correctly understand the complexity and difficulty of shares transfer, and completed every operation task during the share transfer period;
- 2) communicate proactively and publicize widely to complete the Share Reform well;
- 3) organize seriously, co-ordinate effectively to finish the technological renovation on time
- 4) digging potential, using space reasonably and optimizing technical path
- 5) increasing the power for new products development.

During the reporting period, the Company has obtained a turnover of RMB848,419,000 and a net profit for the year of RMB78,153,000, representing an increased of RMB175,776,000 and RMB59,832,000 respectively, as compared with last year's turnover of RMB672,643,000 and net profit of RMB18,321,000. The operating activities for the boring and milling machines had attained a turnover of RMB644,002,000 and a net profit of RMB81,411,000, representing an increase of 46.75% and 148.88% respectively as compared with last year. Non-boring and non-turbo machines had attained a turnover of RMB207,815 and a net profit of RMB636,000, representing an decrease of RMB35,239,000 and an increase of RMB5,005,000 respectively.

(2) Main products comprising 10% or more of the turnover of gross profit

Business or products	Turnover	Cost	Unit: RMB'000
			Gross Profit (%)
Sales and processing machine tool products	644,002	472,028	26.70%
Sales, installation and technical services of highly efficient compressor	177,111	130,336	25.76%

During 2006, the Company had attained a turnover of RMB848,419,000 representing an increase of RMB175,776,000 as compared with 2005. The operating activities for the boring and milling machines had attained an increase in income of RMB205,167,000, representing a growth of 46.75%. On the other hand, Ser had attained an decrease in income of RMB32,663,000, representing a decrease of 15.57%. Based on sales structure, in 2006, the sales of the machine tool products is 75.91% of the total sales revenue, the sales of Ser of turbo machines is 20.88% of the total sales revenue. Their total sales revenue is 96.78% of the total sales revenue, representing 10.67% increase and 10.31% decrease respectively as compared with 2005.

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(3) Reasons of the change in major operating market and the change in structure of major operating costs

In 2006, the Company's consolidated gross profit margin is 27.06%, representing an increase of 0.73% as compared with the gross profit margin of last year, which was 26.33%. The increase of the consolidated gross profit margin is caused by the gross profit margin of boring and milling machines increased 0.63%. Analysis as the following:

- 1) The proportion of manufacturing costs, fuel, power expenses occupied in the principal business costs increased 2.8%, the proportion of direct labor cost in the principal business costs increased 0.97% because of the price of energy sources increase, the staff salary increase and depreciation increase by new fixed assets.
- 2) The proportion of outsourcing processing fee occupied in the principal business costs increased 1.55%, representing an increase amount of RMB29,554,000 due to the enlarged scale of production and sales scale of the Company. The productivity of the Company, especially the machine processing capability began to the bottle-neck. In 2006, the Company has to increase outsourcing to make up the insufficient production capability of the Company.
- 3) The proportion of raw material in the main business costs decreased 5.43% due to the purchasing price decrease, outsourcing increase and the utilization ratio of raw material increase by production and sales scale increase.

(4) Analysis of turnover and market share of main business and products:

Business or products	2005 Turnover	2006 Turnover	Unit: RMB'000
			Increase/ decrease (%)
Business			
General facilities production	130,900	218,536	66.95%
Specified facilities production	140,116	210,078	49.93%
Transportation facilities production	31,296	65,650	109.77%
Other production	93,891	97,173	3.50%
Products			
Horizontal boring and milling machines	194,521	241,779	24.29%
Floor-type boring and milling machines	133,330	224,332	68.25%
Table-type boring and milling machines	33,882	48,084	41.92%
Horizontal machine centers	19,809	52,283	163.94%
Jig boring machines	13,548	22,948	69.38%
Others	1,113	2,011	80.68%
Total	396,203	591,437	49.03%

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(5) Major Suppliers and Customers

		Unit: RMB'000
No.	Suppliers	Purchase Amount
1	Siemens	29,677
2	Shanghai Electric Group Shanghai Electrical Motor Company Limited	23,685
3	Beijing Haiyang Fagor Automation Limited	12,709
4	湖北登峰換熱氣有限公司	9,808
5	杭州氣輪機股份有限公司	8,100
Total		83,979
Purchase for the year		223,691

Note: The purchases from the top 5 suppliers represent 37.54% of the total purchase for the year.

The sales of the top 5 customers is RMB92,279,000, representing 10.88% of the total sales for the year.

(6) Analysis of the changes in assets structures and proportions

		Unit: RMB'000		
Items	As at 31st December, 2006	As at 1st January, 2006	Amount increase/ (decrease)	Increase/ (decrease) (%)
Bills receivable	52,131	19,058	33,073	173.54%
Accounts receivable	134,783	86,505	48,278	55.81%
Other receivables	14,286	23,806	(9,520)	(39.99%)
Prepayments	43,385	26,107	17,278	66.18%
Long-term investment	41,366	32,209	9,157	28.43%
Long-term, short-term bank borrowings	60,000	100,000	(40,000)	(40.00%)
Dividend payable	1,177	2,102	(925)	(44.01%)
Other payables	45,844	29,714	16,130	54.28%
Specific project payable	11,312	6,783	4,529	66.77%
Deferred income	5,237	–	5,237	100%
Principal operating income	848,419	672,643	175,776	26.13%
Principal operating cost	618,795	495,526	123,269	24.88%
Other operating profits	3,619	(483)	4,102	(849.28%)
Investment income	-587	(2,999)	2,412	(80.43%)
Subsidy income	5,485	2,922	2,563	87.71%
Non-operating expenses	9,375	13,783	(4,408)	(31.98%)

- A. Bills receivable increased RMB33,073,000, accounts receivable increased RMB48,278,000 due to sales revenue increased;
- B. Other receivables decreased RMB9,520,000 as compared with last year due to receive RMB9,500,000 borrowings from Pharmacy Group of Xi'an Jiaotong University during the reporting period;
- C. Prepayments increased RMB17,278,000 as compared with last year due to increase the production scale to increase products;

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- D. Long-term equity investments increased RMB9,157,000 due to investment of RMB10,000,000 to Xi'an Ruite National Fast Prototyping and Manufacturing Research Centre Company Limited ("Ruite"), investment of RMB500,000 to Kunji Transportation Company Limited, Provision for impairment loss RMB968,000;
- E. Long-term and short-term bank borrowings decreased due to repaid bank borrowings during the reporting period;
- F. Dividend payable decreased RMB925,000 as compared with last year due to minority shareholders of Shaanxi Hengtong Intelligent Machine Company Limited ("Shaanxi Hengtong") gave up the appropriated but undistributed dividends of the previous years;
- G. Other payables increased RMB16,130,000 due to receive RMB10,000,000 prepayments for purchasing equities of Shannxi Hengtong from Ruite;
- H. Specific project payable increased RMB4,529,000 due to receive RMB4,000,000 specific fund for the project "大型透平壓縮機組集散監控系統項目" and RMB480,000 specific fund for developing high-tech products from Yunnan Provincial Science and Technology Bureau;
- I. Deferred income increased RMB5,237,000 due to Land Appreciation Tax (LAT) payable of RMB10,984,000 of the Company in accordance with the Document No.6, issued by Tax Policy Department, Ministry of Finance in 2005. During the reporting period, the actually LAT was RMB5,049,000 and this incurred the adjustment of an increase of deferred income of RMB5,237,000, an increase of profit of RMB698,000 for the current period, decrease LAT payable of RMB5,935,000.
- J. Other operating profit increased RMB4,102,000 due to the Company received consultant fee RMB2,193,000, profit from selling material of RMB438,000 and disposal unuseful material of RMB992,000;
- K. Investment income increased RMB2,412,000 as compared with last year during the reporting period due to Tos Kunming Company Limited has investment income RMB1,552,000 by calculating under equity method and has investment gained RMB235,000 by selling short-term investment fund, this account still remain loss RMB587,000;
- L. Subsidy income increased RMB2,563,000 as compared with last year due to Xi'an Ser Turbo Machinery Equipment Company Limited received government subsidies RMB2,484,000;
- M. Non-operating expenses was RMB9,375,000, decreased RMB4,408,000 as compared with last year due to the amount of provision on impairment loss on fixed assets and intangible assets was large in 2005, during the reporting period, provision on impairment loss on fixed assets was RMB1,749,000, provision on impairment loss on intangible assets was RMB5,294,000, and loss on disposal fixed assets was RMB2,239,000.

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(7) Analysis of major financial data and changes

Items	At the end of the year	At the beginning of the year	Amount increase/ (decrease)	Unit: RMB'000
				Increase/ (decrease) (%)
Total assets	1,181,895	1,079,184	102,711	9.52
Principal operating profit	228,155	175,290	52,865	30.16
Net profit	78,153	18,321	59,832	326.58
Increased in cash and cash equivalent	(14,219)	(28,376)	14,157	49.89
Share equity	610,752	531,994	78,758	14.80

- 1) Total assets increased because of the production increased and assets scale enlarged during the reporting period. Total assets increased RMB102,711,000, including current assets increased RMB69,932,000 and fixed assets increased RMB32,893,000;
- 2) Principal operating profit increased due to sales revenue increased during the reporting period;
- 3) Net profit increased. Reasons: production and sales scale increased during report period, sales revenue increased so that gross profit increased RMB45,931,000, gross profit margin increased 0.73% to generated gross profit RMB6,193,000; quality of assets improved and written back provision on impairment loss on assets RMB8,561,000 during the report period;
- 4) Cash and cash equivalent increased due to sales increased, net cash inflow increased during the reporting period and repaid bank borrowings and increased investment in fixed assets;
- 5) Share equity increased due to net profit increased in the year 2006.

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

Cash flow generated from operating activities was RMB100,325,000, net cash outflow from investment activities was RMB73,129,000, and net cash outflow from fund raising activities was RMB41,415,000. Net cash flow from operating activities increased RMB38,608,000 as compared with the same period of last year due to sales and providing labor services increased RMB266,579,000. Net cash from investment activities decreased RMB8,882,000 because of purchasing fixed assets increased RMB11,357,000 in 2006. Net cash from fund raising activities decreased RMB15,568,000 due to repaid bank borrowings. The net profits for the year has increased while the increase in cash and cash equivalents have increased because while there was an increase in revenue, accounts receivable also increased, and bank loans are repaid.

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

The amount of contracts newly signed during 2006 is RMB853,451,000, of which 64.31% were CNC machines. Inventories included small number of conventional boring machines and there was no movement of major technical staff.

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(10) Review of operations for subsidiaries and controlling companies

1) Operations of Subsidiaries

Unit: RMB'000

Name of company	Nature of business	Major product or service	Registered share capital	Total assets	Net profit
Xi'an Ser Turbo Machinery Manufacturing Turbo machine Company Limited ("Xi'an Ser")	Manufacturing	Turbo machine	50,000	287,683	16,933
Shaanxi Hentong Intelligent Machine Company Limited ("Shaanxi Hengtong")	Manufacturing	Laser prototyping machine	27,960	20,373	(7,535)
Xi'an Jiaotong University Siyuan Intelligent Electric Apparatus Company Limited ("Intelligent")	Manufacturing	Intelligent electrical appliances	35,000	45,616	(681)
Winko Machines Company Limited ("Winko")	Manufacturing	Computerized embroidery machine	20,230	18,008	(8,067)
TOS Kunming Machine Tool Manufacturing Company Limited ("Tos Kunming")	Manufacturing	Development, design, sales of self-produced machines and accessories	5,000,000 (Euro)	72,511	3,046
Kunji Transportation Company Limited	Transportation	General cargo transportation	500	616	(14)

2) Review of investment income from single subsidiary or controlling company which has impact on net profit of the Company with 10% or more

Unit: RMB'000

Name of company	Principal operating income	Principal operating profit	Net profit
Xi'an Ser	177,111	45,628	16,933
Winko	11,999	3,905	(8,067)
Intelligent	9,096	1,916	(7,535)

3) Analysis of performance of subsidiaries or controlling companies

In 2006, there is a huge loss of RMB8,067,000 in Winko due to the provision for various diminution of RMB6,568,000, including provision on impairment loss on intangible assets RMB1,733,000, on fixed assets RMB1,139,000, on inventories RMB2,827,000 and on bad debt RMB869,000 and loss on disposal of fixed assets of RMB669,000.

There is also a loss of RMB7,535,000 in Shaanxi Hengtong. Reasons: the Company will transfer the equities of Shaanxi Hengtong to Ruite. In accordance with the evaluation results of Shaanxi Hengtong based on the date of 30th June, 2006, the assets of Shaanxi Hengtong decreased RMB4,853,000, including intangible assets decreased RMB3,562,000 and fixed assets decreased RMB504,000; loss on year 2006 operation of RMB2,682,000.

2. Expectations on future development

With the call on developing equipment manufacturing industry by the China government, the machinery tool industry will continue have support from the government and enjoy financial resources and tax favorable policies. The development of other relative industries drive the industry to go further. Being in this circumstance, the Company will continue to develop the market and accelerate the development of new products, increase the workload of technological renovation, empower outside co-operation, and enlarge production and sales scale to ensure the Company's capability for continuing development. Major issues are as below:

- (1) rely on the Company itself, refer technology communication, empower R & D to achieve the breakthrough of new products;
- (2) complete the investment and implement the plans of 2007 technological renovation projects;
- (3) develop the international market to obtain the breakthrough of exporting products;
- (4) reinforce the management team building to ensure to provide sufficient human resources for the reform and development of the Company;
- (5) prepare to establish state-level enterprise technical center.

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3. Investing Activities

Information of the Invested Companies

Name of the subsidiaries and joint venture	Place of registration	Scope of business	Registered Capital (RMB'000)	Investment Proportion	Economic nature	Date of investment	Relationship with the Company
Xi'an Ser	Xi'an City	Design, development and sales of turbo machinery	50,000	45.00%	Limited liability	2001.12	Subsidiary
Shaanxi Hengtong	Xi'an City	Development and sales of machine manufacturing moulds, machinery, equipment, electronic products, software and hardware	27,960	65.34%	Limited liability	2001.12	Subsidiary
Siyuan Intelligent	Xi'an City	Development, manufacture and sale of electronic products, electronic machine and products of electronic power, provide technology services	35,000	78.03%	Limited liability	2002.12	Subsidiary
Winko	Kunming City	Develop, apply and integrate hardware and software, retail, whole sale, purchase on behalf of others and consign electronic products, machinery and electronic machine	20,230	96.74%	Limited liability	2002.11	Subsidiary
Tos Kunming	Kunming City	Development, design, manufacture and sales of machine tool products and high-tech products, repairs of machines	5 million (Euro)	50%	Sino-foreign operation	2005.04	Joint Venture
Changsha Ser Turbo Equipment Company Limited ("Changsha Ser")	Changsha City	Design, development and sales of turbo machines	10,000	95.00%	Limited liability	2004.01	Subsidiary of Xi'an Ser
Hangzhou Ser Gas Engineering Company Limited ("Hangzhou Ser")	Hangzhou City	Design, development and sales of turbo machinery, technology development, retain and whole sale of construction materials, and import and export business	1,200	51.00%	Limited liability	2004.04	Subsidiary of Xi'an Ser
Ruite National Fast Prototyping and Manufacturing Research Center Co., Ltd. ("Ruite")	Xi'an City	Fast prototyping series equipments, automobile mould, automobile design mould, producing moulds, structure design, CNC machine, electromechanical equipments, electronic products, computer software hardware and research, develop, producing, sales technology training and technology consultant service for network engineering	60,000	16.67%	Limited liability	2006.12	Subsidiary
Kunji Transportation	Kunming City	General cargo transportation	500	100%	Limited liability	2006.10	Subsidiary

During the reporting period, the natural person shareholder of Winko, Mr. dou Guoping transferred his 1.24% shareholding of Winko to the Company at nil consideration. After transfer, the Company holds 96.74% shareholding of Winko.

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During the reporting period, the investment amount of the Company was RMB10, 500,000, which includes:

- (1) during the reporting period, the Company invest in Ruite with RMB10,000,000 in cash to obtain 16.67% shareholding of Ruite;
- (2) during the reporting period, the Company invest RMB500,000 to establish Kunji Transportation Company Limited, Kunji Transportation Company Limited is a wholly subsidiary of the Company:

Information of invested company:

Name of invested company	Scope of business	Equity proportion in invested company	Remark
Ruite	Fast prototyping series equipments, automobile mould, automobile design mould, producing moulds, structure design, CNC machine, electromechanical equipments, electronic products, computer software hardware and research, develop, producing, sales technology training and technology consultant service for network engineering	16.67	
Kunji Transportation Company Limited	General cargo transportation	100	

1) Use of proceeds from raised fund

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

2) Use of proceeds from non-raised fund

During the reporting period, there were no investment projects use proceeds from non-raised funds.

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4. THE INFLUENCE ON THE FINANCIAL SITUATION AND OPERATING PERFORMANCE OF THE COMPANY BY THE CHANGES OF THE ACCOUNTING POLICIES AND ACCOUNTING ESTIMATES AFTER THE NEW ACCOUNTING STANDARD ARE APPLIED

Generally, there would not be significant effect on the operating performance of the Company after the new accounting standard being applied, but it is thought that there would be some impact in details, which mainly in the reclassification of the parts of the assets and liabilities items, and the fair value is applied to measure some assets, and so on. Moreover, there were some changes in items of expenses.

- 1) In accordance with the Accounting Standard for Business Enterprises No. 2 – Long-term equity investments, the investment on the subsidiaries would be accounted for at cost in the statement of the parent company, and it would be adjusted in accordance with the equity method of accounting when preparing consolidated financial statements. This policy would not affect the consolidated financial statements, but would affect the accounting for the long-term investment on the subsidiaries and the financial statements of the parent company instead.
- 2) In accordance with the Accounting Standard for Business Enterprises No. 4 – Fixed assets, the follow-up disbursement which couldn't meet the capitalization requirements would be recognized as the profit and loss (administrative expenses).
- 3) In accordance with Accounting Standard for Business Enterprises No. 6 – Intangible assets, our intangible assets would be reclassified as costs and accumulative amortizations. Both of the costs and accumulative amortizations would be adjusted correspondingly at the first day of adopting the new accounting standard. When the useful lives of intangible assets cannot be ascertained, the amortization is not accounted by the straight-line-method any longer, but the devaluation testing should be carried on at the end of the year. The change of the standard concerns the recover of the cost and the reclassification of the amortization accumulations, the policy that no amortization happened to the uncertainty useful lives intangible assets has not much effect on the profit and loss of the Company.
- 4) In accordance with the Accounting Standard for Business Enterprises No. 8 – Impairment of assets, such as the investment properties measured at cost, fixed assets, intangible assets, long-term investment, and construction-in-progress and so on. If there is any evidence of devaluation, the assets would be measured at the lower between the book value and the net realizable value. In principle, the impairment is measured by single asset, when it is difficult to estimate the value receivable, it also might be measured by assets group. There is no any significant change in this policy and the effect is less to the Company.
- 5) In accordance with the Accounting Standard for Business Enterprises No. 9 – Employee compensation, the employee compensation includes various expenses of salaries, benefits and social securities for employees. Parts of the benefits and social securities which were accounted in the profit and loss formerly would be transferred to the cost of the assets correlative based on beneficial objects. The above-mentioned would have influence on some assets and the costs of production, but little on the profit and loss of the current period as a whole.
- 6) In accordance with the Accounting Standard for Business Enterprises No. 12 – Debt restructurings, repaying debt by the way of non-cash assets would be measured by fair value, the difference between the book value of the liabilities and fair value would be recognized as the profit and loss in current period. This policy changes in the measurement and accounting method of the assets in the debt restructurings, and would not influenced much to the Company.

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- 7) In accordance with the Accounting Standard for Business Enterprises No. 16 – Government grants, the government grants except for those which should be transferred to the Special Project Payable according to relative guidance. The other items should be distinguished into the capital expenditure and the expense expenditure separately, and transferred into the deferred income or income of the current period by stages. The impact except for the changes of accounting items, the change of policy would also affect the method of accounting for the government grants, as well as the profit and loss of the current period.
- 8) In accordance with the Accounting Standard for Business Enterprises No. 17 – Borrowing costs, the borrowing costs of the special loan for assets acquisition or production would be capitalized. The borrowing costs of our special loans from the Export –Import Bank of China would be recognized as the cost of the shipping construction instead of financial expenses, and the net income of single ship would be reduced accordingly, also would affect the profit and loss of the current period. Whereas, the borrowing costs of the special exchange loan which does not meet requirement of capitalization would not be capitalized. The change in this policy is expected to influent the current profit and loss of the Company.
- 9) In accordance with the Accounting Standard for Business Enterprises No. 18 – Income taxes, the deferred income tax should be measured by an liabilities method. There should be some differences between the income tax deducted in the Income Statement and the one on basis of accrual basis, definitely, that would impact the net profit of the Company.
- 10) In accordance with the Accounting Standard for Business Enterprises No. 20 – Business Combinations. The consolidation of the enterprises which are not controlled by the same parent company would be measured at fair value. This would impact the method of accounting for the investment and the profit and loss of the current year.
- 11) In accordance with the Accounting Standard for Business Enterprises No. 22 – Recognition and measurement of financial instruments. The available-for-sale financial assets of the Company would be measured at fair value. The difference between the cost and fair value at the balance sheet day would result in the adjustment of the capital reserve. When the assets were sold, the capital reserve alteration would be recognized as the profit and loss. This change would affect shareholders equity and the profit and loss on the day when the assets were sold.
- 12) Fair value estimation. If the financial assets and liabilities are traded in an active market, the fair value would be determined using the market price and revised with the consideration of other factors if necessary. Otherwise, the Company would determine it with specifically valuation technique, and try to use all the market parameters.

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5. Day to day operating of the board of directors

(1) The board of directors' meeting and resolution

- 1) On 6th March, 2006, the third session meeting of the 5th term of Board of Directors in written was held to consider "The Report to All Shareholders In Relation to The Acquisition by Shenyang Machine Tool (Group) Company Limited". The resolution was published in "China Securities Daily", "Shanghai Securities Daily", "Wen Wei Po" and "The Standard" on 10th March, 2006.
- 2) On 15th March, 2006, the fourth session meeting of the 5th term of Board of Directors in written was held to consider "The Report of 2006 Technological Renovation Project". The resolution was published in "China Securities Daily", "Shanghai Securities Daily", "Wen Wei Po" and "The Standard" on 28th March, 2006.
- 3) On 10th April, 2006, the fifth session meeting of the 5th term of Board of Directors was held to consider "The 2005 Annual Report and Summary". The resolution was published in "China Securities Daily", "Shanghai Securities Daily", "Wen Wei Po" and "The Standard" on 12th April, 2006.
- 4) On 18th April, 2006, the sixth session meeting of the 5th term of Board of Directors in written was held to consider "The First Quarterly Report of 2006". The resolution was published in "China Securities Daily", "Shanghai Securities Daily", "Wen Wei Po" and "The Standard" on 24th April, 2006.
- 5) On 19th June, 2006, the seventh session meeting of the 5th term of Board of Directors in written was held to consider "the board of directors authorizes the Chairman or his authorizer for dealing with short-term bank loans".
- 6) On 26th June, 2006, the eighth session meeting of the 5th term of Board of Directors in written was held to consider the proposal of China Fortune Securities Restructure.
- 7) On 14th August, 2006, the ninth session meeting of the 5th term of Board of Directors was held to consider "2006 Interim report and Summary". The resolution was published in "China Securities Daily", "Shanghai Securities Daily", "Wen Wei Po" and "The Standard" on 16th August, 2006.
- 8) On 22nd August, 2006, the tenth session meeting of the 5th term of Board of Directors in written was held to consider appoint and remove directors of Tos Kunming Machine Tool Company Limited.
- 9) On 16th October, 2006, the eleventh session meeting of the 5th term of Board of Directors in written was held to consider "The Third Quarterly Report 2006 ". The resolution was published in "China Securities Daily", "Shanghai Securities Daily", "Wen Wei Po" and "The Standard" on 23rd October, 2006.
- 10) On 20th October, 2006, the twelfth session meeting of the 5th term of Board of Directors in written was held to consider "Share Reform Guide". The resolution was published in "China Securities Daily", "Shanghai Securities Daily", "Wen Wei Po" and "The Standard" on 7th November, 2006.
- 11) On 24th October, 2006, the thirteenth session meeting of the 5th term of Board of Directors in written was held to consider "The report by Yunnan Securities Regulatory Committee required Jiaoda Kunji High-tech Company Limited to examine its Financial Information".
- 12) On 31st October, 2006, the fourteenth session meeting of the 5th term of Board of Directors in written was held to consider "The report on technological renovation projects 2007".

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- 13) On 6th November, 2006, the fifteenth session meeting of the 5th term of Board of Directors in written was held to consider "the connected transaction".
- 14) On 10th November, 2006, the sixteenth session meeting of the 5th term of Board of Directors in written was held to consider "The motion proposes by the Company's largest shareholder-Xi'an Jiaotong University industrial (Group) Incorporation in relation to share increase by transferring capital reserve". The resolution was published in "China Securities Daily", "Shanghai Securities Daily", "Wen Wei Po" and "The Standard" on 16th November, 2006.
- 15) On 10th November, 2006, the seventeenth session meeting of the 5th term of Board of Directors in written was held to consider "Share Reform Proposal", the resolution was published on "Shanghai Securities Daily", "Wen Wei Po" and "The Standard" on 16th November, 2006.
- 16) On 30th December, 2006, the eighteenth session meeting of the 5th term of Board of Directors was held to elect chairman of the board and appoint senior management. The resolution was published in "China Securities Daily", "Shanghai Securities Daily", "Wen Wei Po" and "The Standard" on 4th January, 2007.

During the year, 16 meetings were held (12 were in written) and all resolutions were passed. Directors' attendance refers to Chapter 7 of this report-Corporate Governance.

(2) Implement of Resolution of General Shareholders' Meeting

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

6. Profit appropriated proposal and the proposal of share increase by transferring capital reserve to All Shareholders ("Share Increase")

(1) Profit appropriated proposal

The Company and its subsidiaries have attained a net profit for the year 2006 of RMB78,150,000 in accordance with the PRC GAAP. Pursuant to the Articles of Association of the Company, the profit for the year should offset against losses 44,020,000 first, and then shall transfer RMB3,490,000 to the statutory surplus reserve. The profit attributable to shareholders for the year is RMB30,640,000. Of RMB78,150,000, the Company has attained the net profit of RMB77,080,000, and accumulative undistributed profit to shareholders is RMB31,370,000. In accordance with the accounting principles generally accepted in Hong Kong, the net profit of the Company for the year 2006 is RMB82,481,000. After offsetting loss RMB43,690,000, contributing RMB3,490,000 to the statutory surplus reserve, the profit attributable to shareholders will be RMB35,307,000. Thus, the minimum level of undistributed profit attributable to shareholders will be RMB30,640,000.

The Board recommended distribution of the Company's accumulative undistributed profits in the form of a cash dividend of RMB0.6 dollar for every 10 shares, totally distributing RMB16,994,595.30 to all shareholders based on the aggregate of 283,243,255 shares of the Company.

(2) Proposal for share increase by transferring capital reserve ("Share Increase")

On 22nd December, 2006, the proposal for share increase by transferring capital reserve of Jiaoda Kunji High-Tech Company Limited was considered and approved at the 2006 second extraordinary general meeting. 1.5606 new shares would be allocated for every 10 existing shares to all shareholders by transferring capital reserve. Total increased new shares are 38,235,855 shares. Of which, A Shares increased 28,091,955 shares, and H Shares increase 10,143,900 shares. The proposal was subject to approval by relative government departments before implementation. By 31st December, 2006, the proposal was not implemented. The Share Increase was completed on 7th March, 2007.

DIRECTORS' REPORT

7. Statement Regarding the Use of Funds by the Company's Controlling Shareholder and Other Related Parties

Xi'an Xigema Certified Public Accountant Firm Limited
Xi Hui Qi Zi (2007) No.021

Concerning the Usage of Capital by the Controlling Shareholders and other Related Parties of Jiaoda Kunji High-Tech Company Limited

To all shareholders of the Company:

We have accepted the appointment and audited the financial statements of Jiaoda Kunji High-Tech Company Limited ("the Company") for the year ended 31st December, 2006 and have issued the Xi Hui Shen Zi (2007) 0580 (Audited Report). We have performed audit procedures in the course of our audit of the financial statement for the year 2006 on the use of funds by the Company's Controlling shareholder and other related parties. According to the requirements under "Notice concerning the regulation on the flow of funds between listed companies and other related parties and the provision of guarantees by listed companies to external parties" (Zheng Jian Fa [2003] No. 56).

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

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

The non-operational usage of the Company's capital by its former largest shareholder and its respective subsidiaries at the beginning of the year amounted to RMB9,800,000. There is no accumulated non-operational usage of capital in the year and interest amounted to RMB412,300, with RMB10,212,300 being repaid. As at 31st December, 2006, there is no occurrence of usage of non-operational capital by the Company's former largest shareholder and its respective subsidiaries in this year.

(2) Other Connected Transactions:

- 1) The operational usage of the Company's capital by the Company's largest shareholder and its respective subsidiaries at the beginning of the year amounted to RMB502,800. The accumulated operational usage of capital in the year amounted to RMB1,418,400, with repayment and provision of goods of RMB1,383,100. As at 31st December, 2006, the largest shareholder and its respective subsidiaries' operational usage of capital amounted to RMB538,100.
- 2) The non-operational usage of the Company's capital by the Company's subsidiaries at the beginning of 2006 amounted to RMB16,091,000. The accumulated non-operational usage of the Company's capital interest amounted to RMB880,000, with repayment of RMB1,077,200. As at 31st December, 2006, the company's subsidiaries' non-operational usages of the Company's capital amounted to RMB15,893,800.
- 3) There is no occurrence of usage of capital by related natural person and its controlling legal person, other related person and its connected company in this year.

DIRECTORS' REPORT

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

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

Xian Xigema Certified Public Accountants Firm Limited

Chinese Certified Public Accountant

Fan Min Hua

Chinese Certified Public Accountant

Wang Yong Zhong

Xian, the PRC
18th April, 2007

Appendix: Movements in Non operating capital and other related capital for the year of 2006

Unit: RMB'0000

Non-operational use of capital	Names of shareholders/ controlling parties	Relationship with the company	Items	Balance at the beginning of the year	Advances during the year (exclusive of interest)	Repayments during the year	Balance as at year end	Purpose	Nature
Largest shareholder and its respective subsidiaries	-	-	-	-	-	-	-	-	-
Sub-total	-	-	-	-	-	-	-	-	-
Former largest shareholder	Xi'an Jiaotong University Precision Engineering Company Ltd.	Fellow subsidiary of controlling shareholder	Other account receivable	30.00	-	-	30.00	Temporary payment	Non-operational
	Pharmacy (Group) of Xi'an Jiaotong University	Fellow subsidiary of controlling shareholder	Other account receivable	1,000.00	-	41.23	1,041.23	- Temporary payment	Non-operational
	Pharmacy (Group) of Xi'an Jiaotong University	Fellow subsidiary of controlling shareholder	Other account payable	(50.00)	-	-	(50.00)	- Temporary payment	Non-operational
Sub-total	-	-	-	980.00	-	41.23	1,021.23	-	-
Total	-	-	-	980.00	-	41.23	1,021.23	-	-

DIRECTORS' REPORT

Other related capital	Names of shareholders/ controlling parties	Relationship with the company	Items	Balance at the beginning of the year	Advances during the year (exclusive of interest)	Interest	Repayments during the year	Balance as at year end	Purpose	Nature
Largest shareholder and its respective subsidiaries	Jiaoda HongFan High-Tech Company Ltd.	Fellow subsidiary of controlling shareholder	Prepayment	11.87	55.19	–	54.85	12.21	Purchase of goods	Operational
	Jiaoda HongFan High-Tech Company Ltd.	Fellow subsidiary of controlling shareholder	Account payable	(38.39)	75.05	–	36.66	–	Purchase of goods	Operational
	Xi'an Jiaotong University Precision Engineering Company Ltd.	Fellow subsidiary of controlling shareholder	Other receivables	4.52	–	–	4.52	–	Tender guarantee	Operational
	Xi'an Jiaotong University industrial (Group) Incorporation	Former controlling shareholder	Account receivables	32.28	–	–	32.28	–	Sales of goods	Operational
	Xi'an Jiaotong University industrial (Group) Incorporation	Former controlling shareholder	prepayment	10.00	–	–	10.00	–	Purchase	Operational
	Xi'an Jiaotong University industrial (Group) Incorporation (other group companies)	Former controlling shareholder	Other receivables	30.00	–	–	–	30.00	Construction deposits	Operational
	Xi'an Jiaotong University	Former controlling shareholder	Account receivables	–	3.43	–	–	3.43	Sales of goods	Operational
	Yunnan CY (Group) Company Products Trading Centre	Fellow subsidiary of present controlling shareholder	prepayment	–	8.17	–	–	8.17	Purchase	Operational
Fellow subsidiaries and other related companies	Winko	subsidiary	Other receivables	1,609.10	–	88.00	107.72	1,589.38	Temporary payment	Non-operational
Related persons and legal persons	–	–	–	–	–	–	–	–	–	Non-operational
Other related persons and their subsidiaries	–	–	–	–	–	–	–	–	–	Non-operational
Total	–	–	–	1,659.38	141.84	88.00	246.03	1,643.19	–	–

8. The independent non-executive directors express independent opinion of the Company's accumulated and current external guarantee for the year 2006

In accordance with the requirements under "Notice concerning the regulation on the flow of funds between listed companies and other related parties and the provision of guarantees by listed companies to external parties"(Zheng Jian Fa [2003] No.56), independent non-executive directors of the Company investigated the guarantees by the Company to external parties for the year 2006, and express their independent opinions. The result of the investigation is as follows:

During the reporting period, the Company does not have guarantee to the third party; neither guarantee happened before the reporting period and extended to the reporting period.

Independent non-executive directors

Wayne Yu
Chen Ying
Liu Minghui

April 18, 2007