

INDEPENDENT AUDITOR'S REPORT



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

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

We have audited the consolidated financial statements of Jiaoda Kunji High-Tech Company Limited (the "Company") and its subsidiaries (collectively referred to as the "Group") set out on pages 112 to 153, which comprise the consolidated balance sheet as at 31st 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 judgement, 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 31st 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
18th April, 2007

B. FINANCIAL STATEMENTS PREPARED IN ACCORDANCE WITH ACCOUNTING PRINCIPLES GENERALLY ACCEPTED IN HONG KONG CONSOLIDATED INCOME STATEMENT

FOR THE YEAR ENDED 31ST DECEMBER, 2006

	NOTES	2006 <i>RMB'000</i>	2005 <i>RMB'000</i>
Revenue	6	848,048	672,643
Cost of sales		(614,153)	(497,353)
Gross profit		233,895	175,290
Other income	8	13,814	6,272
Administrative expenses		(78,338)	(77,331)
Distribution costs		(38,417)	(32,897)
Finance costs	9	(5,003)	(6,139)
Other expenses		(21,922)	(32,560)
Impairment loss on available-for-sale investments		–	(680)
Share of results of a jointly controlled entity		1,524	(921)
Profit before taxation	11	105,553	31,034
Taxation	12	(15,069)	(9,752)
Profit for the year		90,484	21,282
Attributable to:			
Equity holders of the Company		82,481	11,001
Minority interests		8,003	10,281
		90,484	21,282
Earnings per share	14	RMB33.7 cents	RMB4.5 cents

CONSOLIDATED BALANCE SHEET

AT 31ST DECEMBER, 2006

	NOTES	2006 RMB'000	2005 RMB'000
NON-CURRENT ASSETS			
Property, plant and equipment	15	396,815	376,819
Prepaid land lease payments	16	24,685	25,289
Prepaid quarter rental	17	3,457	3,551
Goodwill	18	11,490	15,965
Intangible assets	19	12,100	18,802
Interest in an associate	20	10,000	–
Interest in a jointly controlled entity	21	16,473	14,949
		475,020	455,375
CURRENT ASSETS			
Prepaid land lease payments	16	603	603
Inventories	22	260,785	274,503
Trade receivables	23	181,387	104,935
Other receivables		72,461	45,119
Amounts due from related companies	24	–	9,600
Available-for-sale investments	25	7,653	8,524
Tax recoverable		62	62
Pledged bank deposits	26	384	2,109
Bank balances and cash	26	166,410	169,767
		689,745	615,222
CURRENT LIABILITIES			
Trade payables	27	96,480	98,327
Advances from customers	28	220,369	196,940
Other payables		60,722	69,580
Deferred income	29	8,107	4,007
Amount due to an associate	40	10,000	–
Amount due to a jointly controlled entity	40	12,113	–
Amount due to a related company	40	1,432	2,288
Tax payable		9,426	3,344
Obligations under finance leases – due within one year	30	233	235
Bank loans – due within one year	31	40,000	60,000
		458,882	434,721
NET CURRENT ASSETS		230,863	180,501
		705,883	635,876

CONSOLIDATED BALANCE SHEET

AT 31ST DECEMBER, 2006

	NOTES	2006 RMB'000	2005 RMB'000
CAPITAL AND RESERVES			
Share capital	32	245,007	245,007
Reserves		360,615	278,134
Equity attributable to equity holders of the Company		605,622	523,141
Minority interests		67,058	59,098
Total equity		672,680	582,239
NON-CURRENT LIABILITIES			
Obligations under finance leases – due after one year	30	2,985	3,218
Bank loans – due after one year	31	20,000	40,000
Deferred gain	33	3,018	3,219
Other long-term loan	34	7,200	7,200
		33,203	53,637
		705,883	635,876

The consolidated financial statements on pages 112 to 153 were approved and authorised for issue by the Board of Directors on 18th April, 2007 and are signed on its behalf by:

Gao Minghui

DIRECTOR

Zhang Hanrong

DIRECTOR

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

FOR THE YEAR ENDED 31ST DECEMBER, 2006

	Attributable to equity holders of the Company								Total RMB'000
	Share capital RMB'000	Share premium RMB'000	Capital reserve RMB'000	Statutory surplus reserve RMB'000	Statutory public welfare fund RMB'000	(Accumulated losses) retained profits RMB'000	Total RMB'000	Minority interests RMB'000	
At 1st January, 2005	245,007	293,745	10,225	9,292	8,561	(54,690)	512,140	49,698	561,838
Profit for the year and total recognised income for the year	-	-	-	-	-	11,001	11,001	10,281	21,282
Acquisition of additional interest in a subsidiary	-	-	-	-	-	-	-	(881)	(881)
At 31st December, 2005	245,007	293,745	10,225	9,292	8,561	(43,689)	523,141	59,098	582,239
Profit for the year and total recognised income for the year	-	-	-	-	-	82,481	82,481	8,003	90,484
Acquisition of additional interest in a subsidiary	-	-	-	-	-	-	-	(43)	(43)
Transfers	-	-	-	8,561	(8,561)	-	-	-	-
Appropriations	-	-	-	3,485	-	(3,485)	-	-	-
At 31st December, 2006	<u>245,007</u>	<u>293,745</u>	<u>10,225</u>	<u>21,338</u>	<u>-</u>	<u>35,307</u>	<u>605,622</u>	<u>67,058</u>	<u>672,680</u>

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

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

According to Article 167 of PRC Company Law, the statutory public welfare fund is no longer required and therefore, the Group discontinued to recognise its statutory public welfare from 1st January, 2006 onwards. Such statutory public welfare fund was transferred to the statutory surplus reserve during the year.

CONSOLIDATED CASH FLOW STATEMENT

FOR THE YEAR ENDED 31ST DECEMBER, 2006

	2006 RMB'000	2005 RMB'000
OPERATING ACTIVITIES		
Profit before taxation	105,553	31,034
Adjustments for:		
Finance costs	5,003	6,139
Share of results of a jointly controlled entity	(1,524)	921
Interest income	(1,582)	(1,755)
Gain on disposal of available-for-sale investments	(234)	–
Amortisation of prepaid quarter rental	94	94
Amortisation of intangible assets	3,141	4,047
Amortisation of prepaid land lease payments	604	674
Depreciation of property, plant and equipment	28,157	26,910
Impairment loss of trade and other receivables	13,632	11,078
Impairment loss of property, plant and equipment	2,182	5,164
Impairment loss of goodwill	4,475	1,369
Impairment loss of intangible assets	3,561	4,575
Loss on disposal of property, plant and equipment	1,761	1,191
Amortisation of deferred gain	(201)	(201)
Discount on acquisition of additional interest in a subsidiary	(43)	–
Impairment loss on available-for-sale investments	–	680
Research and development costs	3,114	–
Operating cash flows before movements in working capital	167,693	91,920
Decrease in inventories	13,718	44,887
Increase in trade receivables	(91,469)	(21,066)
(Increase) decrease in other receivables	(25,957)	30,008
(Decrease) increase in trade payables	(1,847)	34,820
Increase (decrease) in advances from customers	23,429	(103,994)
(Decrease) increase in other payables	(8,858)	33,849
Cash generated from operations	76,709	110,424
PRC Enterprise Income Tax paid	(8,987)	(10,878)
NET CASH FROM OPERATING ACTIVITIES	67,722	99,546

CONSOLIDATED CASH FLOW STATEMENT

FOR THE YEAR ENDED 31ST DECEMBER, 2006

	2006 RMB'000	2005 RMB'000
INVESTING ACTIVITIES		
Purchase of property, plant and equipment	(53,936)	(64,800)
Investment in an associate	(10,000)	–
Research and development costs paid	(3,114)	–
Investment in a jointly controlled entity	–	(9,848)
Acquisition of additional interest in a subsidiary	–	(931)
Repayment from (advance to) related companies	9,600	(9,600)
Addition of deferred income	4,100	2,657
Proceeds from disposal of property, plant and equipment	1,840	1,003
Decrease in pledged bank deposits	1,725	5,602
Interest received	1,582	1,755
Proceeds from disposal of available-for-sale investments	1,105	–
NET CASH USED IN INVESTING ACTIVITIES	(47,098)	(74,162)
FINANCING ACTIVITIES		
Repayment of bank loans	(80,000)	(77,091)
Interest paid	(5,003)	(6,139)
Repayment to related companies	(856)	(6)
Repayment of obligations under finance leases	(235)	(235)
Repayment of amounts due to related companies	–	(1,103)
New bank loans raised	40,000	40,000
Advance from a jointly controlled entity	12,113	–
Advance from an associate	10,000	–
NET CASH USED IN FINANCING ACTIVITIES	(23,981)	(44,574)
NET DECREASE IN CASH AND CASH EQUIVALENTS	(3,357)	(19,190)
CASH AND CASH EQUIVALENTS AT BEGINNING OF THE YEAR	169,767	188,957
CASH AND CASH EQUIVALENTS AT END OF THE YEAR, represented by bank balances and cash	166,410	169,767

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2006

1. GENERAL

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

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

The Company acts as an investment holding company and it is also engaged in the design, development, manufacture and sale of machine tools, precision measuring equipment and precision transducers. The principal activities of its subsidiaries are set out in note 41.

2. APPLICATION OF NEW AND REVISED HONG KONG FINANCIAL REPORTING STANDARDS

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

The Group has not early applied the following new standards, amendment or interpretations that have been issued but are not yet effective. The directors of the Company anticipate that the application of these standards, amendment and interpretations will have no material impact on the results and the financial position 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 1st January, 2007

² Effective for annual periods beginning on or after 1st January, 2009

³ Effective for annual periods beginning on or after 1st March, 2006

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

⁵ Effective for annual periods beginning on or after 1st June, 2006

⁶ Effective for annual periods beginning on or after 1st November, 2006

⁷ Effective for annual periods beginning on or after 1st March, 2007

⁸ Effective for annual periods beginning on or after 1st January, 2008

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2006

3. SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements have been prepared on the historical cost basis except for certain financial instruments, which are measured at fair values, as explained in the accounting policies set out below.

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 (the "Listing Rules") and by the Hong Kong Companies Ordinance.

Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Company and entities controlled by the Company (its subsidiaries) made up to 31st December each year. 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 subsidiaries.

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

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

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

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

Property, plant and equipment

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

Depreciation is provided to write off the cost of items of property, plant and equipment, other than construction in progress, over their estimated useful lives and after taking into account of their estimated residual values, using the straight-line method.

Construction in progress represents property, plant and equipment in the course of construction for production or for its own use purposes. Construction in progress is carried at cost less any recognised impairment loss. Construction in progress is classified to the appropriate category of property, plant and equipment when completed and ready for intended use. Depreciation of these assets, on the same basis as other property assets, commences when the assets are ready for their intended use.

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2006

3. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

Property, plant and equipment *(Continued)*

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

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

Goodwill

Goodwill arising on acquisitions of subsidiaries for which the agreement date is before 1st January, 2005 represents the excess of the cost of acquisition over the Group's interest in the fair value of the identifiable assets and liabilities of the relevant subsidiaries at the date of acquisition. For previously capitalised goodwill, the Group has discontinued amortisation from 1st January, 2005 onwards, and such goodwill is tested for impairment annually, and whenever there is an indication that cash-generating unit ("CGU") to which the goodwill relates may be impaired (see the accounting policy below).

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

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

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

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

On acquisition of additional interest in subsidiaries, goodwill was calculated as the difference between the consideration paid for the additional interest and the carrying amount of the net assets of the subsidiaries attributable to the additional interest acquired. If the Group's additional interest in the net assets of the subsidiaries exceeds the consideration paid for the additional interest, the excess is recognised in the consolidated income statement.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2006

3. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

Intangible assets

Intangible assets acquired separately and with finite useful lives are carried at cost less accumulated amortisation and any identified impairment loss. 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 as 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.

Interest in an associate

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 associate are incorporated in the consolidated financial statements using the equity method of accounting. Under the equity method, interest in an associate is 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 associate, less any identified impairment loss. When the Group's share of losses of an associate equals or exceeds its interest in that 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, unrealised profits or losses are eliminated to the extent of the Group's interest in the associate, 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.

Jointly controlled entity

Joint venture arrangement that involves the establishment of a separate entity in which venturers have joint control over the economic activity of the entity is referred to as a jointly controlled entity.

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

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2006

3. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

Inventories

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

Financial instruments

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

Financial assets

The Group's financial assets are classified into 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 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 trade receivables, other receivables, amounts due from related companies, pledged bank deposit and bank balances) 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 designated. At each balance sheet date subsequent to initial recognition, available-for-sale financial assets are measured at fair value. Changes in fair value are recognised in equity, until the financial asset is disposed of or is determined to be impaired, at which time, the cumulative gain or loss previously recognised in equity is removed from equity and recognised in profit or loss. Any impairment losses on available-for-sale financial assets are recognised in profit or loss. Impairment losses on available-for-sale equity investments will not reverse in profit or loss in subsequent periods.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2006

3. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

Financial instruments *(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.

An equity instrument is any contract that evidences a residual interest in the assets of a group entity after deducting all of its liabilities. Equity instruments issued by the Company are recorded at the proceeds received, net of direct issue costs.

The Group's financial liabilities including trade payables, advances from customers, other payables, amounts due to an associate/a jointly controlled entity/related companies, obligations under finance leases, bank loans and other long-term loan are subsequently measured at amortised cost, using the effective interest method, after initial recognition.

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 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.

Impairment (other than goodwill)

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

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

Revenue recognition

Revenue is measured at the fair value of the consideration received or receivable and represents amounts receivable for goods sold and services rendered by the Group in the normal course of business, and is stated net of related sales tax and sales returns.

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

Service income is recognised when services are rendered.

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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2006

3. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

Government grants

Government grants are recognised as income over the periods necessary to match them with the related costs. Grants related to depreciable assets are presented as deferred income and are released to income over the useful lives of the assets. Grants related to expense items are recognised in the same period as those expenses are charged in the consolidated income statement and are reported separately as other income. Government grants shall not be recognised until there is reasonable assurance that the entity will comply with the conditions attaching to them.

Research and development expenditures

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

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

The amount initially recognised for internally-generated intangible asset is the sum of the expenditure incurred from the date when the intangible asset first meets the recognition criteria. Where no internally-generated intangible asset can be recognised, development expenditure is charged to profit or loss in the period in which it is incurred.

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.

The Group as lessee

Assets held under finance leases are recognised as assets of the Group at their fair value at the inception of the lease or, if lower, at the present value of the minimum lease payments. The corresponding liability to the lessor is included in the consolidated balance sheet as a finance lease obligation. Lease payments are apportioned between finance charges and reduction of the lease obligation so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are charged directly to profit or loss.

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2006

3. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

Retirement scheme cost

The Group participates in state-managed retirement scheme pursuant to which the Group pays a fixed percentage of its qualifying staff's wages as contribution to the scheme. The contribution payable to the retirement scheme is charged to the consolidated income statement as an expense when employees have rendered service entitling them to the contributions.

Borrowing costs

All borrowing costs are recognised and included in finance costs in the consolidated income statement in the period in which they are incurred.

Taxation

Taxation represents the sum of the income 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 income statement items that are never taxable or deductible. The Group's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the balance sheet date.

Deferred tax is recognised on differences between the carrying amounts of assets and liabilities in the consolidated financial statements and the corresponding tax 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. Deferred tax is charged or credited to 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.

Foreign currencies

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

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2006

4. KEY SOURCES OF ESTIMATION UNCERTAINTY

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

Estimated impairment of goodwill and intangible assets

Determining whether goodwill and intangible assets are impaired requires an estimation of the value in use of the CGUs to which goodwill and intangible assets have been allocated. The value in use calculation requires management of the Group to estimate the future cash flows expected to arise from the CGUs and a suitable discount rate in order to calculate the present value. Where the actual future cash flows are less than expected, a material impairment loss may arise. During the year, impairment losses for goodwill and intangible assets of RMB4,475,000 and RMB3,561,000 were recognised in the consolidated income statement, respectively. Details of the recoverable amount calculation are disclosed in notes 18 and 19.

5. FINANCIAL INSTRUMENTS

(a) Financial risk management objectives and policies

The Group's major financial instruments include available-for-sale investments, trade receivables, other receivables, amounts due from related companies, bank balances, trade payables, other payables, amounts due to an associate/a jointly controlled entity/related companies, obligations under finance leases, bank loans and other loan-term loan. The risks associated with these financial instruments and the policies on how to mitigate these risks are set out below:

Credit risk

The Group's maximum exposure to credit risk in the event of the counterparties' failure to perform their obligations as at the balance sheet date is the carrying amount of trade receivables as stated in the consolidated balance sheet. In order to minimise the credit risk, management of the Group reviews the recoverable amount of each individual debt at each balance sheet date to ensure that adequate impairment losses are made for irrecoverable amounts. In this regard, the directors consider that the Group's credit risk is significantly reduced.

The Group's concentration of credit risk by geographical locations of customers is mainly in the PRC which accounted for over 90% of the trade receivables at 31st December, 2006.

The credit risk on bank balances is limited because the counterparties are largely banks with high credit standing.

Fair value interest rate risk

The Group's fair value interest rate risk mainly relates to fixed-rate bank loans, which are raised from the banks in the PRC. In relation to these fixed-rate loans, the Group aims to keep loans at rates that are comparable to those in the market. In order to achieve this result, the Group negotiated with the banks and entered into various revolving loans such that the interest rate associated with the loans is more or less variable. In this regard, the directors consider that the Group's fair value interest rate risk is minimised.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2006

5. FINANCIAL INSTRUMENTS *(Continued)*

(b) Fair value

The fair value of the Group's financial assets and financial liabilities are determined as follows:

- the fair value of financial assets and financial liabilities with standard terms and conditions and traded on active liquid markets are determined with reference to quoted market bid prices; and
- 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.

The directors consider that the carrying amounts of the Group's financial assets and financial liabilities recorded at amortised cost in the consolidated financial statements approximate their fair values.

6. REVENUE

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

	2006 RMB'000	2005 RMB'000
Sales of goods	806,301	637,886
Rendering of processing and other services	41,747	34,757
	<u>848,048</u>	<u>672,643</u>

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2006

7. SEGMENT INFORMATION

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

Business segments

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

2006

	Boring machines <i>RMB'000</i>	Computerised embroidery machines <i>RMB'000</i>	Intelligent electrical appliances <i>RMB'000</i>	Turbo machines <i>RMB'000</i>	Laser prototyping machines <i>RMB'000</i>	Eliminations <i>RMB'000</i>	Consolidated <i>RMB'000</i>
INCOME AND EXPENSES							
External sales	643,054	10,057	8,880	177,056	9,001	–	848,048
Inter-segment sales	1,562	1,942	–	55	–	(3,559)	–
Total revenue	<u>644,616</u>	<u>11,999</u>	<u>8,880</u>	<u>177,111</u>	<u>9,001</u>	<u>(3,559)</u>	<u>848,048</u>
Inter-segment sales are charged at prevailing market rates.							
Segment results	<u>106,561</u>	<u>(3,440)</u>	<u>(288)</u>	<u>17,300</u>	<u>(3,104)</u>	<u>111</u>	117,140
Unallocated corporate income							13,814
Unallocated corporate expenses							(26,925)
Share of results of a jointly controlled entity							<u>1,524</u>
Profit before taxation							105,553
Taxation							<u>(15,069)</u>
Profit for the year							<u>90,484</u>

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2006

7. SEGMENT INFORMATION *(Continued)*

Business segments *(Continued)*

2006

	Boring machines <i>RMB'000</i>	Computerised embroidery machines <i>RMB'000</i>	Intelligent electrical appliances <i>RMB'000</i>	Turbo machines <i>RMB'000</i>	Laser prototyping machines <i>RMB'000</i>	Eliminations <i>RMB'000</i>	Consolidated <i>RMB'000</i>
ASSETS							
Segment assets	681,446	15,133	44,234	249,166	19,286	(19,009)	990,256
Unallocated corporate assets							174,509
Consolidated total assets							<u>1,164,765</u>
LIABILITIES							
Segment liabilities	(202,327)	(24,719)	(10,821)	(167,208)	(2,630)	19,009	(388,696)
Unallocated corporate liabilities							(103,389)
Consolidated total liabilities							<u>(492,085)</u>
OTHER INFORMATION							
Capital additions	43,872	223	882	8,819	140	–	53,936
Amortisation of prepaid land lease payments	321	–	–	283	–	–	604
Amortisation of prepaid quarter rental	94	–	–	–	–	–	94
Amortisation of intangible assets	1,163	465	452	–	1,061	–	3,141
Depreciation of property, plant and equipment	20,765	700	279	5,843	570	–	28,157
Impairment loss of trade and other receivables	5,942	2,049	251	5,171	219	–	13,632
Impairment loss of property, plant and equipment	314	1,573	–	–	295	–	2,182
Impairment loss of goodwill	–	2,037	–	–	2,438	–	4,475
Impairment loss of intangible assets	–	–	–	–	3,561	–	3,561
Loss on disposal of property, plant and equipment	<u>1,000</u>	<u>362</u>	<u>–</u>	<u>–</u>	<u>399</u>	<u>–</u>	<u>1,761</u>

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2006

7. SEGMENT INFORMATION *(Continued)*

Business segments *(Continued)*

2005

	Boring machines <i>RMB'000</i>	Computerised embroidery machines <i>RMB'000</i>	Intelligent electrical appliances <i>RMB'000</i>	Turbo machines <i>RMB'000</i>	Laser prototyping machines <i>RMB'000</i>	Eliminations <i>RMB'000</i>	Consolidated <i>RMB'000</i>
INCOME AND EXPENSES							
External sales	431,732	8,343	9,998	209,774	12,796	–	672,643
Inter-segment sales	7,103	1,769	374	75,373	–	(84,619)	–
Total revenue	<u>438,835</u>	<u>10,112</u>	<u>10,372</u>	<u>285,147</u>	<u>12,796</u>	<u>(84,619)</u>	<u>672,643</u>
Inter-segment sales are charged at prevailing market rates.							
Segment results	<u>33,753</u>	<u>(10,293)</u>	<u>(7,492)</u>	<u>32,216</u>	<u>(2,021)</u>	<u>(7,105)</u>	<u>39,058</u>
Unallocated corporate income							6,272
Unallocated corporate expenses							(13,375)
Share of results of a jointly controlled entity							(921)
Profit before taxation							31,034
Taxation							(9,752)
Profit for the year							<u>21,282</u>

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2006

7. SEGMENT INFORMATION (Continued)

Business segments (Continued)

2005

	Boring machines RMB'000	Computerised embroidery machines RMB'000	Intelligent electrical appliances RMB'000	Turbo machines RMB'000	Laser prototyping machines RMB'000	Eliminations RMB'000	Consolidated RMB'000
ASSETS							
Segment assets	589,037	22,797	44,564	246,087	26,416	(38,766)	890,135
Unallocated corporate assets							180,462
Consolidated total assets							<u>1,070,597</u>
LIABILITIES							
Segment liabilities	(181,150)	(23,432)	(10,698)	(185,763)	(4,150)	33,090	(372,103)
Unallocated corporate liabilities							(116,255)
Consolidated total liabilities							<u>(488,358)</u>
OTHER INFORMATION							
Capital additions	44,313	7,288	5,807	10,128	1,395	–	68,931
Amortisation of prepaid land lease payments	321	–	–	353	–	–	674
Amortisation of prepaid quarter rental	94	–	–	–	–	–	94
Amortisation of intangible assets	1,265	405	905	–	1,472	–	4,047
Depreciation of property, plant and equipment	19,275	1,082	300	5,584	669	–	26,910
Impairment loss of trade and other receivables	5,711	910	18	4,942	(503)	–	11,078
Impairment loss of property, plant and equipment	936	4,228	–	–	–	–	5,164
Impairment loss of goodwill	–	692	677	–	–	–	1,369
Impairment loss of intangible assets	–	1,861	2,714	–	–	–	4,575
Loss on disposal of property, plant and equipment	<u>128</u>	<u>908</u>	<u>22</u>	<u>133</u>	<u>–</u>	<u>–</u>	<u>1,191</u>

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2006

8. OTHER INCOME

	2006 RMB'000	2005 RMB'000
Other income comprises:		
Government grants and other incentives for new products	5,489	4,086
Interest income on bank deposits	1,582	1,755
Gain on disposal of available-for-sale investments	234	—
Amortisation of deferred gain	201	201
Discount on acquisition of additional interest in a subsidiary	43	—
Rental income in respect of property, plant and equipment	30	40
Others	6,235	190
	13,814	6,272

9. FINANCE COSTS

	2006 RMB'000	2005 RMB'000
Interest on:		
Bank loans wholly repayable within five years	4,874	6,010
Obligations under finance leases	129	129
	5,003	6,139

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2006

10. DIRECTORS' REMUNERATION AND FIVE HIGHEST PAID EMPLOYEES

The emoluments paid or payable to each of the fifteen (2005: fifteen) directors were as follows:

2006

	Fee RMB'000	Salaries and other benefits RMB'000	Performance related incentive payments RMB'000	Retirement scheme contributions RMB'000	Total RMB'000
Executive directors					
Zhang Hanrong	24	267	380	10	681
Cheng Yunchuan	24	163	130	10	327
Wu Ketian	24	121	90	10	245
Lei Jinlu	36	—	—	—	36
Non-executive directors					
Wang Shangjin	18	180	—	—	198
Guo Shangwu	24	—	—	—	24
Luo Guowei	18	—	—	—	18
Wen Peixiong	18	—	—	—	18
Gao Minghui	6	—	—	—	6
Sun Kai	6	—	—	—	6
Wang Shen	6	—	—	—	6
Independent non-executive directors					
Tong Yunhuan	36	—	—	—	36
Yu Chengting	36	—	—	—	36
Yu Weifeng Wayne	36	—	—	—	36
Dong Juan	24	—	—	—	24
	336	731	600	30	1,697

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2006

10. DIRECTORS' REMUNERATION AND FIVE HIGHEST PAID EMPLOYEES *(Continued)*

2005

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

The five highest paid individuals in the Group for both years were all directors of the Company, details of their remunerations are set out above.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2006

11. PROFIT BEFORE TAXATION

	2006 RMB'000	2005 RMB'000
Profit before taxation has been arrived at after charging:		
Directors' and Supervisors' remuneration		
Fees		
Executive Directors and Supervisors	204	200
Non-Executive Directors	96	93
Independent Non-Executive Directors	132	128
Other emoluments		
Executive Directors and Supervisors	1,633	920
Non-Executive Directors	180	180
Independent Non-Executive Directors	–	–
Retirement scheme contributions	30	30
	2,275	1,551
Other retirement scheme contributions	6,136	5,557
Other employee benefits expenses	95,162	76,980
	103,573	84,088
Total employee benefits expenses		
	103,573	84,088
Auditors' remuneration	1,882	1,849
Depreciation and amortisation:		
Amortisation of prepaid land lease payments	604	674
Amortisation of prepaid quarter rental (included in other expenses)	94	94
Amortisation of intangible assets (included in other expenses)	3,141	4,047
Depreciation of property, plant and equipment		
Owned assets	27,508	26,261
Assets held under finance leases	649	649
Cost of inventories recognised as an expense	591,622	496,056
Impairment loss of:		
Property, plant and equipment (included in other expenses)	2,182	5,164
Goodwill (included in other expenses)	4,475	1,369
Intangible assets (included in other expenses)	3,561	4,575
Trade and other receivables	13,632	11,078
Loss on disposal of property, plant and equipment	1,761	1,191
Research and development costs expensed	3,114	2,543
Operating lease rental in respect of rental premises	1,980	2,760

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2006

12. TAXATION

The amount represents PRC Enterprise Income Tax calculated at the rates applicable to the Company and its subsidiaries.

Pursuant to a document issued by the PRC State Tax Bureau on 21st October, 1993 and confirmed by a notice issued by the Ministry of Finance and the State Tax Bureau on 18th April, 1994, the Company's profit is subject to PRC Enterprise Income Tax at a rate of 15% as from 1st January, 1993. In addition, certain of the Company's PRC subsidiaries are also subject to PRC Enterprise Income Tax at a rate of 15%.

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

	2006 RMB'000	2005 RMB'000
Profit before taxation	105,553	31,034
Tax at the PRC Enterprise Income Tax rate of 15% (2005: 15%)	15,833	4,655
Tax effect of expenses not deductible for tax purpose	2,621	5,166
Tax effect of income not taxable for tax purpose	(3,584)	(69)
Tax effect of different tax rates in other jurisdictions	199	—
Taxation charge for the year	15,069	9,752

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

13. APPROPRIATIONS

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

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

An appropriation of RMB3,485,000 was made for the year ended 31st December, 2006.

14. EARNINGS PER SHARE

The calculation of earnings per share is based on the profit for the year attributable to equity holders of the Company of RMB82,481,000 (2005: RMB11,001,000) and the 245,007,400 (2005: 245,007,400) shares in issue throughout the year.

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2006

15. PROPERTY, PLANT AND EQUIPMENT

	Buildings under medium term lease in the PRC RMB'000	Plant and machinery RMB'000	Furniture, fixtures and equipment RMB'000	Motor vehicles RMB'000	Construction in progress RMB'000	Total RMB'000
COST						
At 1st January, 2005	184,379	215,195	44,362	17,574	58,787	520,297
Additions	1,814	31,748	3,222	2,851	29,246	68,881
Transfers	23,386	13,631	–	–	(37,017)	–
Transfer to a jointly controlled entity	(3,277)	(357)	(81)	(1,019)	(2,929)	(7,663)
Disposals	(1,020)	(1,754)	(220)	(660)	–	(3,654)
At 31st December, 2005	205,282	258,463	47,283	18,746	48,087	577,861
Additions	–	7,090	1,789	1,192	43,865	53,936
Transfers	28,353	17,685	–	–	(46,038)	–
Disposals	(1,904)	(5,008)	(769)	(305)	–	(7,986)
At 31st December, 2006	231,731	278,230	48,303	19,633	45,914	623,811
DEPRECIATION AND IMPAIRMENT						
At 1st January, 2005	27,268	114,571	22,923	5,124	1,635	171,521
Provided for the year	7,309	15,064	3,247	1,290	–	26,910
Eliminated on transfer to a jointly controlled entity	(1,338)	(180)	(14)	(109)	–	(1,641)
Impairment loss	–	4,229	–	–	935	5,164
Eliminated on disposals	(57)	(541)	(165)	(149)	–	(912)
At 31st December, 2005	33,182	133,143	25,991	6,156	2,570	201,042
Provided for the year	7,242	14,636	3,781	2,498	–	28,157
Impairment loss	–	1,664	24	180	314	2,182
Eliminated on disposals	(393)	(2,999)	(748)	(245)	–	(4,385)
At 31st December, 2006	40,031	146,444	29,048	8,589	2,884	226,996
CARRYING VALUES						
At 31st December, 2006	191,700	131,786	19,255	11,044	43,030	396,815
At 31st December, 2005	172,100	125,320	21,292	12,590	45,517	376,819

The above items of property, plant and equipment, other than construction in progress, are depreciated on a straight-line basis at the following rates per annum:

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2006

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

During the year, the directors conducted a review of the Group's manufacturing assets and determined that certain assets were impaired due to physical damage and technical obsolescence. Accordingly, an aggregate impairment loss of RMB2,182,000 (2005: RMB5,164,000) in respect of plant and machinery and construction in progress was recognised in the consolidated income statement, based on their existing condition and shortage of their recoverable amounts to their carrying amount. The recoverable amounts of the relevant assets have been determined on the basis of their value in use.

At 31st December, 2006, the carrying values of Group's buildings and motor vehicles of RMB3,465,000 (2005: RMB3,488,000) and RMB877,000 (2005: RMB1,535,000) are held for rental income under operating leases and held under finance leases, respectively.

16. PREPAID LAND LEASE PAYMENTS

The Group's prepaid land lease payments comprise land use rights in the PRC held under medium-term leases and are analysed for reporting purposes as follows:

	2006 RMB'000	2005 RMB'000
Current asset	603	603
Non-current asset	24,685	25,289
	<u>25,288</u>	<u>25,892</u>

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

17. PREPAID QUARTER RETANL

Pursuant to an agreement entered into between the Company and Kun Ji Group Company ("Kun Ji") on 10th December, 1993, the Company and Kun Ji paid RMB2,000,000 and RMB3,000,000 respectively for the purpose of joint construction of staff quarters. During the year ended 31st December, 1995, a further sum of RMB297,000 was paid by the Company. The staff quarters were completed in October 1995. Subsequently, Kun Ji is entitled to the ownership of the staff quarters and the Company is entitled to lease five floors as staff quarters for 48 years commencing January 1996. The lease rental is calculated with reference to the floor area occupied and the actual construction cost of the building. On this basis, a further sum of RMB2,189,000 was paid by the Company during the year ended 31st December 1996, bringing the aggregate sum prepaid for the quarter rental to RMB4,486,000 which is amortised over the lease period of 48 years.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2006

18. GOODWILL

	<i>RMB'000</i>
COST	
At 1st January, 2005, 31st December, 2005 and 31st December, 2006	17,334
IMPAIRMENT	
At 1st January, 2005	–
Recognised for the year	1,369
At 31st December, 2005	1,369
Recognised for the year	4,475
At 31st December, 2006	5,844
CARRYING VALUES	
At 31st December, 2006	11,490
At 31st December, 2005	15,965

The amortisation period adopted for goodwill was 10 years prior to 1st January, 2005. For the purpose of impairment testing, goodwill arising on business combinations is allocated to the CGUs that are expected to benefit from these business combinations. The carrying values of goodwill are allocated to the following CGUs:

	2006 <i>RMB'000</i>	2005 <i>RMB'000</i>
Turbo machines	5,843	5,843
Intelligent electrical appliances	3,270	3,270
Laser prototyping machines	2,377	4,815
Computerised embroidery machines	–	2,037
	11,490	15,965

In view of the operating loss derived from the manufacture and sale of computerised embroidery machines unit, an impairment loss of goodwill derived from the CGU of computerised embroidery machines in relation to RMB2,037,000 was recognised by the Group for the year.

In addition, management of the Group determined that the recoverable amount of goodwill derived from the CGU of laser prototyping machines is less than its carrying value and an impairment loss of RMB2,438,000 was recognised by the Group for the year.

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

The recoverable amount of the laser prototyping machines unit is determined based on a consideration of a proposed disposal of laser prototyping machines unit in which a potential buyer proposed to acquire the Company's entire interest of 76.36% in Shanxi Hengtong Intelligent Machine Company Limited ("Hengtong") in March, 2007 (the "Proposed Disposal"). Details of the Proposed Disposal are disclosed in note 42.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2006

18. GOODWILL *(Continued)*

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

The Group prepares cash flow forecasts derived from the most recent financial budgets approved by management for the next year and extrapolates cash flows for the following four years based on estimated steady growth rates of 5%, 3% and 2% for turbo machines unit, intelligent electrical appliances machines unit and computerised embroidery machines unit, respectively. These rates do not exceed the average long-term growth rate for the relevant markets. The rates used to discount the forecast cash flows for these CGUs range from 5.8% to 10.1% (2005: 5.1%) per annum.

19. INTANGIBLE ASSETS

	<i>RMB'000</i>
COST	
At 1st January, 2005, 31st December, 2005 and 31st December, 2006	37,014
AMORTISATION AND IMPAIRMENT	
At 1st January, 2005	9,590
Charge for the year	4,047
Impairment loss recognised in the year	4,575
At 31st December, 2005	18,212
Charge for the year	3,141
Impairment loss recognised in the year	3,561
At 31st December, 2006	24,914
CARRYING VALUES	
At 31st December, 2006	12,100
At 31st December, 2005	18,802

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2006

19. INTANGIBLE ASSETS *(Continued)*

The technical knowhow was purchased as part of business combinations in prior years and is amortised over a period of 10 years. The carrying values of technical knowhow are allocated to the following CGUs:

	2006 RMB'000	2005 RMB'000
Laser prototyping machines	4,216	8,838
Boring machines	5,623	6,786
Others	2,261	3,178
	<u>12,100</u>	<u>18,802</u>

At 31st December, 2006, the directors determined that the recoverable amount of intangible assets under the CGU of laser prototyping machines was less than its carrying value and an impairment loss of RMB3,561,000 (2005: RMB4,575,000) in relation to the technical knowhow for the usage of laser prototyping and manufacturing technology was recognised in the consolidated income statement. The recoverable amount of the laser prototyping machines unit is determined based on the consideration of the Proposed Disposal of the laser prototyping machines unit. Details of the Proposed Disposal are disclosed in note 42.

20. INTEREST IN AN ASSOCIATE

	2006 RMB'000	2005 RMB'000
Cost of unlisted investment in an associate	<u>10,000</u>	<u>—</u>

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

Name of entity	Form of business structure	Place of registration/operation	Proportion of nominal value of registered capital held by the Group	Proportion of voting power held	Principal activities
西安瑞特快速制造工程研究有限公司 Ruite National Fast Prototyping and Manufacturing Research Center Company Limited ("Ruite")	Limited liability corporation	PRC	16.67%	16.67%	Design, development, manufacture and sale of machine tools

Ruite was established in the PRC during the year. At 31st December, 2006, Ruite recorded a total assets of RMB60,000,000 and did not incur any liabilities. Ruite did not have any revenue and profit or loss arising during the year.

In the opinion of the directors, the Group has the power to exercise significant influence over Ruite and it is therefore accounted for as an associate of the Group.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2006

21. INTEREST IN A JOINTLY CONTROLLED ENTITY

	2006 RMB'000	2005 RMB'000
Cost of unlisted investment in a jointly controlled entity	15,870	15,870
Share of post-acquisition results	603	(921)
	16,473	14,949

As at 31st December, 2006, the Group had interest in the following jointly controlled entity:

Name of entity	Form of business structure	Place of registration/operation	Proportion of nominal value of registered capital held by the Group	Proportion of voting power held	Principal activities
昆明道斯機床有限公司 TOS Kunming Machine Tool Company Limited ("TOS")	Sino-foreign joint venture	PRC	50%	50%	Design, development, manufacture and sale of machine tools

The summarised financial information, after elimination of the effect of unrealised fair value adjustment of property, plant and equipment contributed to the jointly controlled entity, in respect of the Group's jointly controlled entity which is accounted for using the equity method is set out below:

	2006 RMB'000	2005 RMB'000
Non-current assets	9,178	10,554
Current assets	18,220	6,740
Current liabilities	(10,925)	(2,345)
Income	19,478	2,910
Expenses	(17,954)	(3,831)

22. INVENTORIES

	2006 RMB'000	2005 RMB'000
Raw materials	49,194	55,294
Work-in-progress	155,648	146,630
Finished goods	55,943	72,579
	260,785	274,503

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2006

23. TRADE RECEIVABLES

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

	2006 RMB'000	2005 RMB'000
Within one year	169,149	86,076
Between one and two years	11,474	17,545
Between two and three years	670	930
Over three years	94	384
	181,387	104,935

24. AMOUNTS DUE FROM RELATED COMPANIES

The amounts were owed by certain substantial shareholders of the Company and were fully repaid during the year, details of which are set out in note 40.

25. AVAILABLE-FOR-SALE INVESTMENTS

	2006 RMB'000	2005 RMB'000
Unlisted unit fund in the PRC (note a)	–	871
Listed shares in the PRC (note b)	7,653	7,653
	7,653	8,524

Notes:

- (a) At 31st December, 2005, these available-for-sale investments were stated at fair value which was determined by reference to the unit prices quoted by security house. The Group fully disposed these investments during the year.
- (b) During the year ended 31st December, 2004, the Company entered into an agreement with China Fortune Securities Company Limited ("China Fortune") for the trusteeship of the management of investment in state bonds (the "Trusteeship Agreement"), pursuant to which the Company entrusted China Fortune to conduct investment on state bonds with RMB50,000,000 (the "Funds") with a term of the entrustment of one year from 23rd February, 2004 to 23rd February, 2005.

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

Subsequent to 7th June, 2004, the Company found that China Fortune incurred operating failure and was taken over in custody by China Huarong Asset Management Corporation ("China Huarong") as appointed by the China Securities Regulatory Commission.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2006

25. AVAILABLE-FOR-SALE INVESTMENTS *(Continued)*

In January 2006, the China Securities Regulatory Commission approved the application from a shareholder of China Fortune, Capital Airport Group Company ("Capital Airport"), for handling the restructuring process of China Fortune with an authorised period of six months. However, Capital Airport could not obtain approval from the existing creditors for the restructuring proposal of settlement of liabilities by shares before the due date. As a result, the restructuring process was terminated.

In August 2006, the China Securities Regulatory Commission appointed Beijing Gao Peng Tianda Law Firm ("Gao Peng") to establish an administrative liquidation working group to execute the liquidation of China Fortune (the "Liquidation"). The Liquidation is still in progress.

In the opinion of the directors, the Company has good claims on the underlying assets held in the investment account with China Fortune despite that China Fortune breached its contract. However, as China Fortune is undergoing liquidation and these available-for-sale investments cannot be freely traded in an active market, the directors consider that range of reasonable fair value estimates of these available-for-sale investments is so significant that their fair value cannot be determined reliably and accordingly, these investments are stated at carrying values of RMB7,653,000 as at 31st December, 2006. The fair value of these investments was approximately RMB13,000,000 as at 31st December, 2006 by reference to the bid price quoted in the active market as at that date.

26. PLEDGED BANK DEPOSITS/BANK BALANCES

The pledged bank deposits represent deposits pledged to banks to secure general banking facilities granted to the Group and therefore are classified as current assets.

The pledged bank deposits and bank balances carry interest at interest rates ranging from 0.72% to 2.43% (2005: 0.72% to 2.25%) per annum.

27. TRADE PAYABLES

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

	2006 RMB'000	2005 RMB'000
Within one year	81,881	77,648
Between one and two years	7,987	18,901
Between two and three years	4,764	450
Over three years	1,848	1,328
	<u>96,480</u>	<u>98,327</u>

28. ADVANCES FROM CUSTOMERS

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

29. DEFERRED INCOME

The amount represents government subsidy of RMB8,107,000 (2005: RMB4,007,000) received by the Group for upgrading its manufacturing plant. The amount has been accounted for as deferred income and will be transferred to income over the useful lives of the relevant assets upon the completion of upgrading the manufacturing plant.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2006

30. OBLIGATIONS UNDER FINANCE LEASES

	Minimum lease payments		Present value of minimum lease payments	
	2006	2005	2006	2005
	RMB'000	RMB'000	RMB'000	RMB'000
The obligations under finance leases are repayable as follows:				
Within one year	366	366	233	235
Between two and five years	1,370	1,392	853	853
More than five years	3,422	3,764	2,132	2,365
	<u>5,158</u>	<u>5,522</u>	<u>3,218</u>	<u>3,453</u>
Less: Future finance charges	(1,940)	(2,069)	–	–
Present value of lease obligations	<u>3,218</u>	<u>3,453</u>	<u>3,218</u>	<u>3,453</u>
Less: Amount due within one year shown under current liabilities			(233)	(235)
Amount due after one year			<u>2,985</u>	<u>3,218</u>

The Group leases certain of its buildings and motor vehicles under finance leases. The average term of the finance leases is 20 (2005: 20) years. Interest rates underlying the obligations under finance leases are fixed at respective contract dates of 3% (2005: 3%) per annum. No arrangements have been entered into for contingent rental payments.

31. BANK LOANS

	2006	2005
	RMB'000	RMB'000
The bank loans are repayable as follows:		
On demand or within one year	40,000	60,000
Between one to two years	20,000	40,000
	<u>60,000</u>	<u>100,000</u>
Analysed as:		
Secured	40,000	34,000
Unsecured	20,000	66,000
	<u>60,000</u>	<u>100,000</u>

All bank loans carry fixed-rate interest ranging from 5.850% to 6.300% (2005: 5.580% to 5.859%) per annum.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2006

32. SHARE CAPITAL

	Registered, issued and fully paid 2006 & 2005 RMB'000
Ordinary shares of RMB1 each:	
A shares	180,007
H shares	65,000
	<u>245,007</u>

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

33. DEFERRED GAIN

	RMB'000
GROSS AMOUNT	
At 1st January, 2005, 31st December, 2005 and 31st December, 2006	<u>4,023</u>
AMORTISATION	
At 1st January, 2005	603
Amortised during the year	<u>201</u>
At 31st December, 2005	804
Amortised during the year	<u>201</u>
At 31st December, 2006	<u>1,005</u>
CARRYING VALUES	
At 31st December, 2006	<u><u>3,018</u></u>
At 31st December, 2005	<u><u>3,219</u></u>

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

34. OTHER LONG-TERM LOAN

The amount, which represents government grant for working capital of a construction project which is still in progress, is unsecured, non-interest bearing and will not be repayable until the project is completed. After the project is completed, the government grant will be transferred to deferred income and recognised as income over the useful lives of relevant assets. In the opinion of the directors, the project will not be completed within the next twelve months and the fair value of the loan was approximately RMB6,900,000.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2006

35. OPERATING LEASE COMMITMENTS

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

	2006 RMB'000	2005 RMB'000
Within one year	1,992	2,242
In second to fifth years inclusive	7,487	8,738
Over five years	18,126	23,690
	<u>27,605</u>	<u>34,670</u>

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

36. CAPITAL COMMITMENTS

	2006 RMB'000	2005 RMB'000
Capital expenditure contracted for but not provided in the financial statements in respect of acquisition of property, plant and equipment	<u>59,416</u>	<u>47,293</u>

37. PLEDGE OF ASSETS

At 31st December, 2006, the Group's prepaid lease payments with carrying value of RMB11,773,000 (2005: land and buildings of RMB21,915,000) and time deposits of RMB384,000 (2005: RMB2,109,000) were pledged to secure bank loans granted to the Group.

38. RETIREMENT BENEFIT SCHEME

The Group is a participant in a state-managed retirement benefit scheme pursuant to which the Group pays a fixed percentage of its qualifying staff's wages as contributions to the scheme. The Group's financial obligations under this scheme are limited to the payment of the employer's contribution.

During the year, the contributions made by the Group relating to the arrangement were RMB6,166,000 (2005: RMB5,587,000). There was no forfeited contribution for reduction in the Group's future contribution during the year.

39. MAJOR NON-CASH TRANSACTIONS

During the year ended 31st December, 2005, the Group had the following major non-cash transactions:

- The Group disposed of two buildings in an aggregate carrying value RMB548,000 to a director and an employee of the Company in lieu of cash bonuses due to them.
- Part of the consideration for the establishment of the jointly controlled entity represented the transfer of property, plant and equipment at an aggregate carrying value of RMB6,022,000 in lieu of cash.
- The Group transferred its inventories at cost of RMB4,081,000 to property, plant and equipment.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2006

40. CONNECTED PARTY AND RELATED PARTY TRANSACTIONS AND BALANCES

During the year, the Group had significant transactions with connected parties as defined in the Listing Rules. The transactions with these connected parties and related parties during the year and balances with them at the balance sheet date are as follows:

(A) TRANSACTIONS WITH CONNECTED PARTIES

Name of party	Nature of transactions	2006 RMB'000	2005 RMB'000
<i>Substantial shareholders of the Company:</i>			
Xian Jiaotong University Industrial (Group) Incorporation ("Jiaotong Group") (note a)	Interest expense for short-term borrowing paid by the Group	–	101
	License fee expense for operating services in university buildings paid by the Group	–	1,229
	Purchase of materials by the Group (note b)	549	1,748
	Rental expenses paid by the Group (note c)	471	587
	Research and development expenditures paid by the Group (note d)	1,150	1,150
	Sales of finished goods by the Group (note b)	–	1,297
	Utility service fees paid by the Group (note c)	731	776
Yunnan Provincial People's Government ("Yunnan Government")	Interest expense on obligations under finance leases paid by the Group (note e)	<u>129</u>	<u>129</u>
<i>Company controlled by the substantial shareholders</i>			
Kun Ji	Payment by the Group for building management fees, and provision of social, education and medical services to the Company's employees (note f)	1,305	1,269
	Rental for building paid by the Group	1,828	2,170
	Sales of finished goods by the Group (note b)	3	356
	Construction cost paid by the Group	<u>–</u>	<u>740</u>
<i>Director of the Company</i>			
Mr. Zhang Hanrong	Disposal of building to a director in lieu of cash bonuses due to him	<u>–</u>	<u>267</u>

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2006

40. CONNECTED PARTY AND RELATED PARTY TRANSACTIONS AND BALANCES *(Continued)*

(B) BALANCES WITH CONNECTED PARTIES

Name of party	Nature of balances	2006 RMB'000	2005 RMB'000
<i>Substantial shareholders of the Company</i>			
Jiaotong Group (note a)	Balance due from (to)		
	– non-trade receivable (note h)	–	100
	– non-trade payable (note h)	–	(475)
		<u>–</u>	<u>(375)</u>
		<u>(3,198)</u>	<u>(3,453)</u>
Yunnan Government	Balance of obligations under finance leases (note e, h)	<u>(3,198)</u>	<u>(3,453)</u>
<i>Company controlled by the substantial shareholders</i>			
Kun Ji	Balance due to		
	– non-trade payable (note h)	(1,432)	(1,783)
	– trade payable (note h, i)	–	(30)
		<u>(1,432)</u>	<u>(1,813)</u>
Pharmacy Group of Xian Jiaotong University	Balance due from		
	– non-trade receivable (note i, j)	–	9,500

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2006

40. CONNECTED PARTY AND RELATED PARTY TRANSACTIONS AND BALANCES *(Continued)*

(C) TRANSACTIONS WITH RELATED PARTIES

Other than the above transaction with Mr. Zhang Hanrong, a director of the Company, the Group had the following transactions with the related parties:

Name of party	Nature of transactions	2006 RMB'000	2005 RMB'000
<i>Management of the Company</i>			
Ms. Yu Yan	Disposal of building by the Group (note g)	259	—
Mr. Pei Xi An	Disposal of building by the Group (note g)	262	—
Mr. Zhao Nai Bing	Disposal of building by the Group (note g)	259	—
<i>Jointly controlled entity</i>			
TOS	Consultancy fee earned by the Group	2,255	—
	Disposal of property, plant and equipment by the Group	12	—
	Purchase of materials by the Group (note b)	38,923	6,600
	Sales of finished goods by the Group (note b)	3,387	1,913
	Sales of scrapped material by the Group (note b)	539	—

(D) BALANCES WITH RELATED PARTIES

Name of party	Nature of balances	2006 RMB'000	2005 RMB'000
<i>Jointly controlled entity</i>			
TOS	Balance due from (to)		
	– non-trade payable (note h)	(17,213)	—
	– non-trade receivable (note h)	1,134	—
	– trade payable (note h, i)	(994)	—
	– trade receivable (note h, i)	4,960	—
		(12,113)	—
<i>Associate</i>			
Ruite	Balance due to		
	– non-trade payable (note h)	10,000	—

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2006

40. CONNECTED PARTY AND RELATED PARTY TRANSACTIONS AND BALANCES *(Continued)*

(E) OTHER STATE-OWNED ENTITIES IN THE PRC

The Group operates in an economic regime currently predominated by entities directly or indirectly owned by the PRC government through its government authorities, agencies, affiliations and other organisations ("state-owned entities"). Transactions with other state-owned entities include but are not limited to the followings:

- purchase, sale and leases of property and other assets; and
- rendering and receiving of utilities and other services.

These transactions are conducted in the ordinary course of the Group's business on terms similar to those that would have been entered into with non-state-owned entities. The Group has also established its pricing strategy and approval processes for major products and services. Such pricing strategy and approval processes do not depend on whether the customers are state-owned entities or not. Having due regard to the substance of the relationship, the directors of the Company are of the opinion that none of these transactions are related party transactions that require separate disclosure.

Notes:

- Jiaotong Group is the former substantial shareholder of the Company. On 1st December, 2006, Jiaotong Group disposed of its entire interest of 29% (which represented 71,052,146 shares) in the Company to Shengyang Machine Tool (Group) Company Limited.
- These transactions were carried at price agreed by both parties.
- The Company entered into an agreement with Jiaotong Group in 2001 whereby Jiaotong Group provides certain housing facilities and utilities services to the Group at prices to be determined by reference to the state stipulated price for utility services.
- Research and development expenditures were determined by terms agreed by both parties.
- Upon disposal of its land and buildings to Yunnan Government during the year ended 31st December, 2001, the Group entered into separate agreements with Yunnan Government to lease back certain land and buildings for a term of 20 years. The balance with Yunnan Government as the lessor of these arrangements is set out in note 30, obligations under finance leases. The relevant interest expenses on obligations under finance leases were determined with reference to the prevailing market rates.
- The receipt and payment of these service income and expenses were priced with reference to a composite services agreement entered into between Kun Ji and the Company in 1993 and renewed in 2005.
- The Group disposed three buildings in an aggregate carrying value of RMB780,000 to the senior management of the Company.
- The balances are unsecured, interest-free and repayable on demand.
- At the balance sheet date, the amount was aged within one year.
- The amount was unsecured, interest bearing at 5.5% per annum and was fully settled during the year.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2006

41. PARTICULARS OF SUBSIDIARIES

Details of the Company's subsidiaries at 31st December, 2006 are as follows:

Name of subsidiary	Form of business structure	Place of registration/ operations	Registered capital	Proportion of paid up capital held by the Company		Principal activities
				Directly	Indirectly	
西安賽爾機泵成套設備有限公司 Xian Ser Turbo Machinery Equipment Company Limited	Limited liability corporation	PRC	RMB50,000,000	45% (Note)	–	Design, develop and sales of turbo-machinery
長沙賽爾機泵成套設備有限責任公司 Changsha Ser Turbo Machinery Equipment Company Limited	Limited liability corporation	PRC	RMB10,000,000	–	43% (Note)	Design, develop and sales of turbo-machinery
杭州賽爾氣體設備工程有限公司 Hangzhou Ser Gas Engineering Company Limited	Limited liability corporation	PRC	RMB1,200,000	–	23% (Note)	Design, develop and sales of turbo-machinery
陝西恆通智能機器有限公司 Shanxi Hengtong Intelligent Machine Company Limited	Limited liability corporation	PRC	RMB27,960,000	65.34%	–	Develop and sale of manufacturing moulds, machinery, equipment, electronic products, software and hardware
西安交大思源智能電器有限公司 Xian Jiaotong University Siyuan Intelligent Electric Apparatus Company Limited	Limited liability corporation	PRC	RMB35,000,000	78.03%	–	Research, develop, manufacturing and sale of automatic machines for industries such as water utilities, civil engineering and construction
昆明交大昆機自動機器有限公司 Winko Machines Company Limited	Limited liability corporation	PRC	RMB20,230,000	96.74%	–	Research, develop, manufacturing and sale of intelligent computerised coloured embroidery machines
昆明機床運輸有限責任公司 Kunming Machines Shipping Company Limited	Limited liability corporation	PRC	RMB500,000	100%	–	Transport of machine tool

Note: The Company has the power to appoint over 50% of number of directors of the companies and has retained the Company's controlling power over the companies. Accordingly, these companies are accounted for as subsidiaries of the Company.

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31ST DECEMBER, 2006

42. POST BALANCE SHEET EVENTS

Subsequent to the balance sheet date, a minority shareholder transferred his entire interest of 11.02% in Hengtong without any consideration to the Company. Accordingly, the interest in Hengtong held by the Company was increased from 65.38% to 76.36%. In March, 2007, a potential buyer proposed to acquire the Company's entire interest of 76.36% in Hengtong for a consideration of RMB14,000,000. Until the date of signing this report, the Proposed Disposal has not yet been completed.