



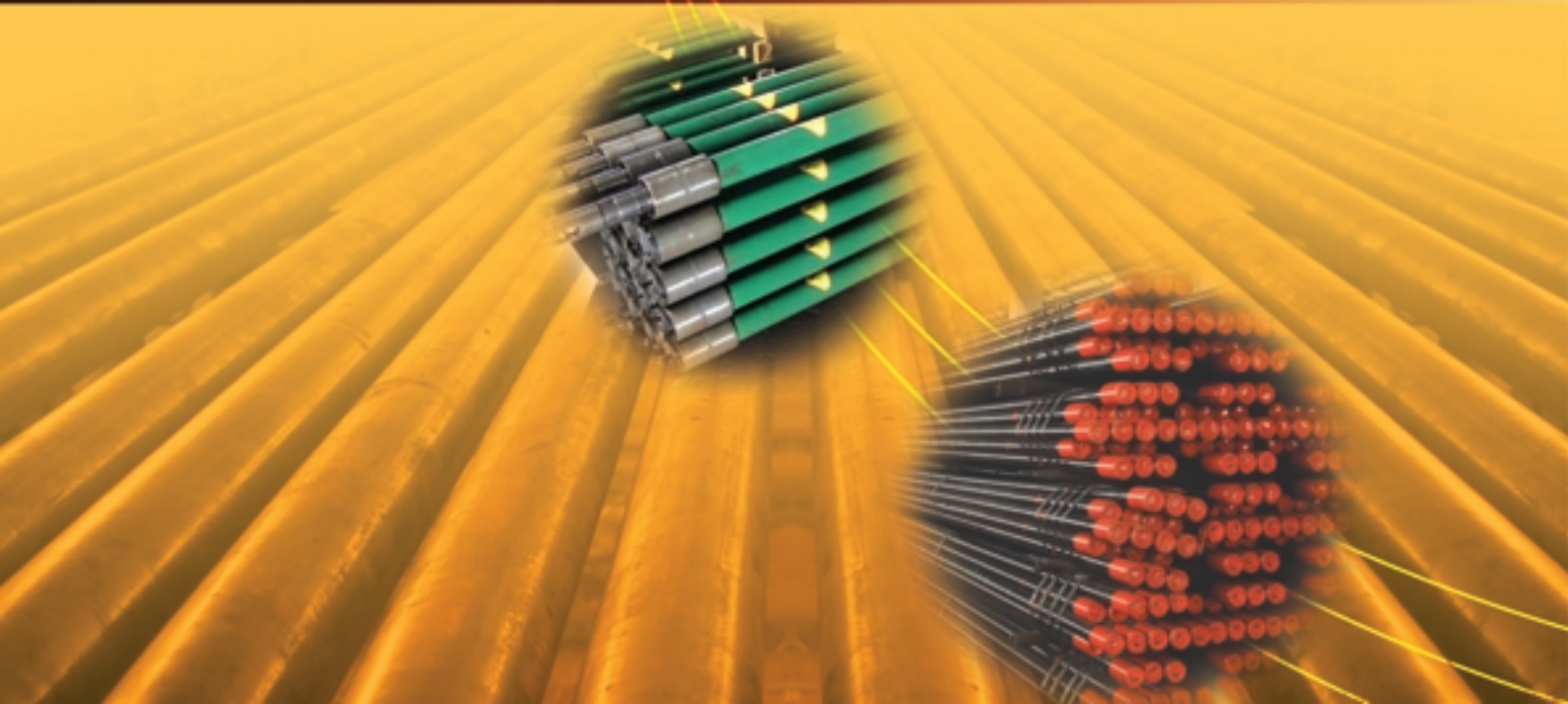
山東墨龍石油機械股份有限公司

Shandong Molong Petroleum Machinery Company Limited

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



2004  
Annual Report



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*This report, for which the directors of Shandong Molong Petroleum Machinery Company Limited (the “Company”) collectively and individually accept full responsibility, includes particulars given in compliance with the Rules Governing the Listing of Securities on the GEM of the Stock Exchange (the “GEM Listing Rules”) for the purpose of giving information with regard to the Company. The directors of the Company (the “Directors”), having made all reasonable enquiries, confirm that, to the best of their knowledge and belief: (1) the information contained in this report is accurate and complete in all material respects and not misleading; (2) there are no other matters the omission of which would make any statement in this report misleading; and (3) all opinions expressed in this report have been arrived at after due and careful consideration and are founded on bases and assumptions that are fair and reasonable.*

3	Corporate Information
5	Financial Highlights
6	Chairman's Statement
9	Management Discussion and Analysis
13	Comparison of Business Objectives with Actual Business Progress
16	Directors, Supervisors and Senior Management
20	Directors' Report
30	Supervisors' Report
31	Auditors' Report
32	Consolidated Profit and Loss Account
33	Consolidated Balance Sheet
34	Consolidated Statement of Changes in Equity
35	Consolidated Cash Flow Statement
37	Balance Sheet
38	Notes to the Financial Statements
65	Notice of Annual General Meeting

## Directors

### Executive Directors

Mr. Zhang En Rong (*Chairman*)

Mr. Zhang Yun San

Mr. Lin Fu Long

Mr. Xie Xin Cang

### Non-executive Directors

Mr. Chen Jian Xiong

Mr. Wang Ping

### Independent non-executive Directors

Mr. Qin Xue Chang

Mr. Yan Yi Zhuang

Mr. Loke Yu alias Loke Hoi Lam

### Supervisors

Ms. Li Bao Hui

Mr. Liu Wan Fu

Mr. Fan Ren Yi

### Members of Audit Committee

Mr. Qin Xue Chang (*Chairman of the Audit Committee*)

Mr. Yan Yi Zhuang

Mr. Loke Yu alias Loke Hoi Lam

### Qualified Accountant

Mr. Chan Wing Nang, Billy, *ACA, CPA*

### Company Secretary

Mr. Chan Wing Nang, Billy, *ACA, CPA*

### Compliance Officer

Mr. Xie Xin Cang

### Authorised Representatives

Mr. Xie Xin Cang

Mr. Chan Wing Nang, Billy, *ACA, CPA*

### Authorised Person to Accept Service of Process and Notices

Mr. Chan Wing Nang, Billy, *ACA, CPA*

## Auditors

Ernst & Young

## Compliance Adviser

Deloitte & Touche Corporate Finance Limited

## Legal Advisers

Mallesons Stephen Jaques (As to Hong Kong Law)

Hao Tian Law Office (As to PRC Law)

## Principal Bankers

Agricultural Bank of China

Bank of China

Industrial Bank Co., Ltd.

Weifang Commercial Bank

## Hong Kong Share Registrar and Transfer Office

Tricor Investor Services Limited

G/F., Bank of East Asia Harbour View Centre

56 Gloucester Road

Wanchai

Hong Kong

## Registered Address

No. 99 Beihai Road, Shouguang City

Shandong Province, the People's Republic of China

## Principal Place of Business in Hong Kong

Suite F, 10/F

Ho Lee Commercial Building

38-44 D'Aguilar Street

Central

Hong Kong

## Website

[www.molonggroup.com](http://www.molonggroup.com)

## Stock Code

8261

## Results

### Year ended 31 December

	<b>2004</b>	2003	2002	2001
	<b>RMB'000</b>	RMB'000	RMB'000	RMB'000
Turnover	<b>487,688</b>	302,274	197,776	154,308
Profit from operating activities	<b>70,148</b>	64,085	28,777	14,029
Profit before tax	<b>65,576</b>	59,347	26,555	13,296
Profit before minority interests	<b>64,091</b>	46,150	18,632	12,312
Minority interests	<b>(2,725)</b>	(2,173)	466	(784)
Net profit from ordinary activities attributable to shareholders	<b>61,366</b>	43,977	19,098	11,528
Earnings per share – basic (RMB dollars)	<b>0.122</b>	0.109	0.047	0.0285

## Assets and Liabilities

### As at 31 December

	<b>2004</b>	2003	2002	2001
	<b>RMB'000</b>	RMB'000	RMB'000	RMB'000
Total assets	<b>467,059</b>	383,356	330,906	203,549
Total liabilities	<b>220,415</b>	264,457	192,893	126,396
Minority interests	<b>1,090</b>	4,814	45,630	3,868
Net assets	<b>245,554</b>	114,085	92,383	73,285



On behalf of the board of Directors (the "Board") of the Company, I am pleased to present the annual report and the audited financial statements of the Company together with its subsidiary (collectively the "Group") for the financial year ended 31 December 2004 to the shareholders of the Company (the "Shareholders").

## Outstanding Achievements for the Year

The Group recorded extremely encouraging business growth during the last year. For the year ended 31 December 2004, the Group's turnover was approximately RMB487.7 million, representing an increase of approximately 61.3% as compared with the previous year. Over the same period, the Group's net profit from ordinary activities attributable to Shareholders and earnings per share were approximately RMB61.4 million and RMB0.122, representing an increase of approximately 39.5% and 11.9% respectively as compared with the previous year. All these results clearly demonstrated the persistent effort in the growth of the Group's business.

## Business Review

The successful listing of the Company on the GEM of the Stock Exchange on 15 April 2004 represented not only an important milestone for the Group in 2004 but also a significant progress in the Group's development, marking a new era of the Group. By utilising the proceeds from the listing, the Group was able to further enhance the core competitiveness of the Group both domestically and internationally and capture its edge in both product development and industrial expansion in the petroleum extraction machinery industry.

Following the listing, the Group's productivity improved significantly with the injection of additional resources into the Group, among which, the production of oil well sucker rods and oil well pipes have surpassed the production targets as originally set out in the prospectus of the Company dated 30 March 2004 (the "Prospectus"), while projects of special seamless oil well pipes and super-strength oil well sucker rods have also been put into operation ahead of schedule and achieved inspiring results.

In terms of market exploration, currently, the Group's customers are mainly oil fields of the subsidiaries or branches of PetroChina Company Limited ("PetroChina") and China Petroleum & Chemical Corporation ("Sinopec"), including Daqing Oil Field (大庆油田), Shengli Oil Field (胜利油田), Xinjiang Oil Field (新疆油田), Zhongyuan Oil Field (中原油田) and Liaohe Oil Field (辽河油田). Apart from consolidating relationships with the existing customers, the Group also further explored new domestic and overseas markets, including the Changqing Oil Field (长庆油田) in Shaanxi province, North America, the United Kingdom, Russia, France, Indonesia, the Middle East, Brunei, Egypt and Syria successfully. During the year under review, the turnover of the Group generated from exporting its products to overseas market increased significantly, laying a solid foundation for the Group's future development of overseas markets.



During the year under review, the Group has signed a "Letter of Intent of Co-operation" with Petroleum Pipe Co. Ltd. of the United Kingdom to sell the Group's products to overseas markets through its international sales network. The management believes that, through the strategic co-operation, the Group's market share can be further enhanced.

Since its incorporation, the Group has been placing great emphasis on maintaining close relationship with its customers as well as providing them with value-added services. During the year under review, the Group has successfully implemented the Enterprise Resources Planning ("ERP") system which has facilitated internal communications, improved the efficiency in resources deployment and the quality of management and provided the latest market and product information for its international and domestic customers.

In order to apply the capital resources in the most cost-effective way and to cater for future development, the Group conducted business restructuring during the year under review. The Company and Shouguang Maolong Machinery Company Limited (壽光懋隆機械電氣有限公司) ("Maolong Machinery") resolved to liquidate Shouguang Molong Machinery Company Limited (壽光市墨龍機械有限公司) ("Molong Machinery") and to transfer its assets and businesses relating to the oil well sucker rods and oil well pumps to a newly incorporated subsidiary of the Company, Weifang Molong Drilling Equipment Company Limited (濰坊墨龍鑽探設備有限公司) ("Molong Drilling Equipment"). As Molong Drilling Equipment is entitled to enjoy a simplified tax regime in the PRC, the Group can reduce its operating expenses and improve its cash flow position. The Board believes that the above business restructuring is beneficial to the long term development of the Group.

In addition, the management considers that quality of raw materials is vital in ensuring the high quality of the Group's products. During the year under review, the Group has entered into a "Strategic Co-operation Agreement" with the largest supplier of the Group, pursuant to which the supply of raw materials was secured.

During the year under review, the Group also obtained a number of accreditations from the People's Government of Shandong Province and the Agricultural Bank of China, including "Top 50 Industrial Enterprises of Weifang City in 2004", "Top 100 Sales Income and Tax Paying Enterprises in Shandong Province for Three Consecutive Years", "Class A Tax Paying and Good Credit Entity" and "AAA Good Credit Enterprise".





## Prospects

Owing to the increase in the global demand for petroleum, the impact of political instability and occurrence of terrorist activities, the price of crude oil continued to increase in 2004. In addition, the rapid development of the economy in the PRC has further boosted the market demand for crude oil.

According to the "China Statistics Yearbook 2004", the proportion of petroleum to total energy consumption in the PRC has increased from 18.0% in 1996 to 22.7% in 2003. The PRC is currently the world's second largest crude oil consuming country. The PRC Government has been paying more attention to petroleum resources and has indicated that it will implement special policies in providing funds and resources to the petroleum industry in order to promote the development of petroleum industry, increase petroleum reserves and stabilise supplies of petroleum resources. The management are of the view that, if the policies are implemented successfully, the domestic petroleum extraction machinery and related accessories industry will grow rapidly. It will also bring unlimited business opportunities to the Group.

In order to maintain the Group's market competitiveness, the Group will continue to invest in its business, conduct research and development of new products, improve its productivity and expand the Group's production capacity by constructing new production facilities. At the same time, the Group will also increase its marketing activities in order to further expand the market coverage in both domestic and overseas markets. The Directors believe that by virtue of its advantages in product research and development and production capacity, the Group will be able to capture business opportunities, provide high quality petroleum extraction machinery and accessories for domestic and overseas petroleum extraction companies and generate satisfactory returns to the Shareholders, as it did in the past.

## Acknowledgement

Lastly, I would like to express my gratitude to the Shareholders and business partners of the Group for their support and encouragement for the past year, and at the same time, my most sincere thanks to the Directors and all the staff of the Group for their dedication and contribution.

**Zhang En Rong**

Chairman

Shandong, the PRC

16 March, 2005

## Financial Review

The following discussion and analysis of the Group's financial condition and results of operation should be read in conjunction with the consolidated financial statements and the accompanying notes.

### Turnover

For the year ended 31 December 2004, the Group's turnover increased significantly as a result of increasing market demand in petroleum machinery industry. The Group's turnover was approximately RMB302.3 million for the year ended 31 December 2003 and surged to approximately RMB487.7 million for the year ended 31 December 2004, which was principally derived from the sale of oil well pipes, oil well sucker rods, oil well pumps, casing, oil well pumping machines and other petroleum extraction machinery accessories.

As compared to the previous year, the Group's turnover rapidly increased due to the growing sales of oil well pipes. In addition, oil well pipes, oil well sucker rods and casing were successfully launched into new overseas markets. The Directors believe that the Group's commitment in providing quality products is crucial in maintaining its competitive edge in the PRC and overseas markets.

### Gross Profit

The Group's gross profit increased from approximately RMB75.4 million for the year ended 31 December 2003 to approximately RMB96.7 million for the year ended 31 December 2004, representing an increase of approximately 28.2% as compared to the previous year. The substantial growth was mainly due to the rapid increase in turnover.

### Consolidated Gross Profit Margin

The consolidated gross profit margin of the Group decreased from approximately 24.9% for the year ended 31 December 2003 to approximately 19.8% for the year ended 31 December 2004, representing a decrease of approximately 5.1%. The main reason for the slight decrease in the consolidated gross profit margin was the change of the products mix of the Group. Compared to other products' gross profit margins, the gross profit margin of oil well pipes was approximately 15.2%, which is relatively lower. Owing to the huge demand for oil well pipes, speedy market development as well as enhancement of production capacity, the turnover of oil well pipes increased rapidly from approximately RMB134.5 million in 2003 to approximately RMB261.4 million in 2004, the ratio in the total turnover increased from 44.5% in 2003 to 53.6% in 2004.

### Net Profit from Ordinary Activities Attributable to Shareholders

The Group's net profit from ordinary activities attributable to Shareholders increased from approximately RMB44.0 million for the year ended 31 December 2003 to approximately RMB61.4 million for the year ended 31 December 2004, representing an increase of approximately 39.5% as compared to the previous year. The substantial increase was mainly due to the rapid increase in turnover and gross profit.



## Cost of Sales & Selling and Distribution Costs

The Group's cost of sales increased from approximately RMB226.9 million for the year ended 31 December 2003 to approximately RMB391.0 million for the year ended 31 December 2004, representing an increase of approximately 72.4% as compared to the previous year. The significant increase in cost of sales was mainly attributable to the growth of the Group's turnover.

The transportation costs also increased by approximately RMB4.4 million for the year ended 31 December 2004.

## Administrative Expenses

The Group's administrative expenses increased from approximately RMB11.1 million for the year ended 31 December 2003 to approximately RMB14.3 million for the year ended 31 December 2004, representing an increase of approximately 28.8% as compared to the previous year. The increase in administrative expenses was mainly attributable to the increase in the cost of emoluments and staff benefits by approximately RMB1.2 million for the year ended 31 December 2004.

## Finance Costs

The finance costs of the Group for the year ended 31 December 2004 was approximately RMB4.6 million, representing approximately 0.9% of the Group's total turnover and a decrease of approximately RMB0.2 million over last year. The decrease in finance costs was principally due to the Group's enhancement of capital control.

## Research and Development Costs

The research and development costs of the Group for the year ended 31 December 2004 was approximately RMB4.0 million, representing approximately 0.8% of the Group's total turnover and a decrease of approximately RMB0.2 million over last year.

## Liquidity and Financial Resources

The Group generally financed its operations and investment activities by internal financial resources and banking facilities provided by banks in the PRC. As at 31 December 2004, the Group had outstanding bank loans of approximately RMB30.0 million.

As at 31 December 2004, the Group had a net cash and cash equivalents of approximately RMB26.1 million (2003: approximately RMB63.1 million) and pledged time deposits of approximately RMB61.9 million (2003: approximately RMB34.1 million). Net current assets of the Group was approximately RMB113.0 million (2003: approximately RMB50.8 million). The Directors consider that the Group has sufficient financial resources to meet its liabilities and commitments.

## Gearing Ratio

The Group's gearing ratio was approximately 47.2% (2003: 69.0%) which is calculated based on the Group's total liabilities of approximately RMB220.4 million (2003: approximately RMB264.5 million) and total assets of approximately RMB467.1 million (2003: approximately RMB383.4 million).

## Pledge of Assets

The bank loan of RMB15.0 million was secured by certain equipment of the Group.

## Contingent Liabilities

As at 31 December 2004, the Group did not have any material contingent liabilities (2003: RMB6.0 million). The Company had provided counter-guarantee to Shandong International Trust and Investment Corporation ("SDITIC") in relation to the guarantee granted by SDITIC to the Company for bills payable of RMB6.0 million as at 30 June 2004. The counter-guarantee provided by the Company to SDITIC is by way of pledging the Company's beneficiary interests under a Fund Management Trust Agreement entered into between the Company and SDITIC dated 27 September 2003.

## Banking Facilities

As at 31 December 2004, the Group had bank loans amounting to RMB30.0 million including a loan amounting to RMB15.0 million secured by certain equipment of the Group and an unsecured loan amounting to RMB15.0 million of the Company. In addition, the Agricultural Bank of China and CITIC Industrial Bank has granted credit facilities amounting to RMB150.0 million and RMB40.0 million to the Group, respectively, which have not been utilised.

## Foreign Exchange Exposure

For the financial year ended 31 December 2004, approximately 18.3% of the Group's operating revenue is denominated in US dollars and the rest are denominated in RMB. The cost of sales and capital of the Group are mainly denominated in RMB. The official exchange rate between US dollars and RMB has generally been stable in recent years. The Directors consider that the Group's exposure to fluctuation in foreign exchange rate was minimal and, accordingly, the Group did not employ any financial instruments for hedging purposes.

## Segment Information

An analysis of the Group's turnover and segment results by geographical segment for the year ended 31 December 2004 is set out in note 4 to the financial statements.

## Capital Commitment

As at 31 December 2004, the Group had contracted capital commitments of approximately RMB128.0 million (2003: approximately RMB1.9 million) in respect of fixed assets.



## Employees

As at 31 December 2004, the Group had a total of 1,308 employees (31 December 2003: 1,105). For the year ended 31 December 2004, staff costs including directors' remuneration were approximately RMB16.7 million (31 December 2003: RMB11.2 million). The Group's employment and remuneration policies remain unchanged from those described in the Prospectus. The salaries and benefits of employees of the Group are kept at a competitive level and employees are rewarded on a performance related basis within the general framework of the Group's salary and bonus system which is reviewed annually. A wide range of benefits are also provided to the employees by the Company.

As at 31 December 2004, the breakdown of the number of employees of the Group was set out below:

	As at 31 December	
	2004	2003
Research and development	47	40
Production	975	790
Quality control	78	77
Sales and marketing	52	45
Administration	156	153
Total	<b>1,308</b>	<b>1,105</b>

The Group keeps a close watch on the levels of employees' remuneration and benefits and rewards staff according to the results of the Group's operating profits. Furthermore, the Group also offers training and development opportunities to employees.

## Significant Investments

There were no significant investments held by the Group as at 31 December 2004.

## Material Acquisitions and Disposals during the Year and Future Plans for Investment

Save for the business restructuring by way of liquidation of the Group's subsidiary, Molong Machinery and the transfer of its assets and the businesses relating to oil well sucker rods and oil well pumps to a newly established subsidiary, Molong Drilling Equipment, the Group did not have any material acquisitions or disposals of subsidiaries and associated companies during the year ended 31 December 2004.



The net proceeds from the placing and public offer of H shares by the Company on 15 April 2004, which amounted to approximately HK\$76.35 million, was intended to be used by the Directors as stated in the Prospectus and out of which approximately HK\$5.4 million was used for general working capital. As at 31 December 2004, the Group has utilised the proceeds as follows:

	<b>Proposed use of proceeds as at 31 December 2004 as stated in the Prospectus HK\$ million</b>	<b>Actual amount used as at 31 December 2004 HK\$ million</b>	<b>Remaining proceeds as at 31 December 2004 HK\$ million</b>
Research and development	4.70	5.20	1.20
Expansion of production capacity	21.50	37.30	—
Production improvement and development	22.00	22.50	0.80
Sales and marketing	0.55	1.55	0.40
Human resources	0.70	0.90	0.60
Certification	0.10	0.10	0.40
<b>Total</b>	<b>49.55</b>	<b>67.55</b>	<b>3.40</b>

The Group has accelerated its production capacity expansion and certain projects were completed prior to their scheduled time as set out in the Prospectus owing to the rising demand for petroleum extraction machinery. In this regard, certain investment costs, which were initially expected to be expended in 2005 and 2006, were utilised accordingly.

**Comparisons of the business objectives set out in the Prospectus with the actual business progress for the period from 22 March 2004 to 31 December 2004 are as follows:**

<i>Business objectives as stated in Prospectus</i>	<i>Actual business progress</i>
<i>Research and development</i>	
Technology for production of super-strength oil well sucker rod	Technology for production of super-strength oil well sucker rod has been developed
Energy conservation technology in oil well pumping machines	Energy conservation technology has been developed
To develop a packer jointly with the Zhongyuan Institute	The development of the packer has been completed
To continue research and development on petroleum extraction machinery and related accessories	The planned research and development has been achieved



## *Business objectives as stated in Prospectus*

## *Actual business progress*

### *Expansion of production capacity*

To achieve annual production capacity of oil well pumps to approximately 10,000 units

The planned annual production capacity has been achieved

To achieve annual production capacity of oil well sucker rods to approximately 3,000,000 meters

The annual production capacity of oil well sucker rods has been increased to approximately 3,500,000 meters

To achieve annual production capacity of oil well pumping machines to approximately 200 units

The planned annual production capacity has been achieved

To achieve annual production capacity of oil well pipes to approximately 35,000 tons

The annual production capacity of oil well pipes has been increased to approximately 55,000 tons

To maintain annual production capacity of underground petro-electric pumps to approximately 200 units

The planned annual production capacity has been maintained

To maintain annual production capacity of blade-guide pulleys to approximately 150,000 sets

The planned annual production capacity has been maintained

To achieve annual production capacity of valves to approximately 60,000 pieces

The planned annual production capacity has been achieved

To maintain annual production capacity of fluid injection pumps to approximately 300 units

The planned annual production capacity has been maintained

To achieve annual production capacity of mud pump steel sleeves to approximately 33,000 pieces

The planned annual production capacity has been achieved

To complete the construction of new production facilities for super-strength oil well sucker rods and to achieve annual production capacity to approximately 40,000 tons

The construction of new production facilities for super-strength oil well sucker rods has been completed and the planned annual production capacity has been achieved

To construct new production facilities for special seamless oil well pipes

Successfully developed special seamless oil well pipes. The construction of new production facilities has been completed with an annual production capacity of approximately 60,000 tons



***Business objectives as stated in Prospectus***

***Actual business progress***

*Production improvement and development*

To develop oil well pipes which can withstand high pressure

Successfully developed oil well pipes which can withstand high pressure. The construction of new production facilities has been completed with an annual production capacity of approximately 60,000 tons

To develop advance and reliable oil well sucker rods by utilising high quality steel raw materials and to construct the production facilities for oil well sucker rods

The development of advanced and reliable oil well suck rods and the construction of relevant production facilities completed

To enhance oil well pumps performance under specific oil well conditions, such as anti-corrosion, sand-proof, etc.

The objective has been achieved

To enhance system operations for oil well pumping machines

The objective has been achieved

*Sales and marketing*

To refine and increase the speed for the Group's official website and to further understand domestic and foreign market of petroleum machinery

The Group's official website has been revamped and its speed has also been increased

To reinforce current sales network (domestic and foreign) and simultaneously to further explore markets in North America and the Middle East by sending sales principals to North America and the Middle East

Sales principals have been sent to North America and the Middle East, sales agents were appointed and direct business relationships with certain clients have been established

*Human resources*

To expand the Group's work force by recruiting high caliber individuals from time to time

The objective, including the recruitment of suitable personnel responsible for research and development, production, quality control, sales and marketing and administration, has been achieved

*Certification*

To obtain new and/or renew existing National Industrial Product Manufacturing Licenses for oil well pumps, oil well sucker rods and oil well pumping machines

The renewal of existing National Industrial Product Manufacturing Licenses has been completed





## Directors

### Executive Directors

*Mr. Zhang En Rong (張恩榮先生)*, aged 65, is the chairman of the Company and executive Director. Mr. Zhang is a founder of the Company and is responsible for the overall strategic planning and management and business development of the Group. Since its establishment, Mr. Zhang held various positions in the Group including general manager. Mr. Zhang was also a member of the 12th session, 13th session and 14th session of the Weifang City People's Congress of the PRC, a member of the 5th session and the 6th session of the Shandong Shouguang City Committee of the Chinese People's Political Consultative Conference. Mr. Zhang was the legal representative and factory manager of Shandong Shouguang Petroleum Machinery Parts Factory ("Petroleum Machinery Parts Factory"), Shandong Shouguang Petroleum Machinery Factory ("Petroleum Machinery Factory") and Weifang Molong Industrial Company ("Weifang Molong") from 1987 to 1993 and the general manager of Shandong Molong Holdings Company ("Molong Holdings") from 1994 to 2001. Mr. Zhang was granted the "Good Enterprise Management Personnel" certificate in 1988, the "Modern Industrial Manufacturing Producer" in 1991 and the "Wealth Attainment and Development of Shandong" medal of Shandong Province in 2004 (山東省「富民興魯」勞動獎章). Mr. Zhang is the father of Zhang Yun San, an executive Director.

*Mr. Zhang Yun San (張雲三先生)*, aged 43, is a founder, the deputy chairman, executive Director and deputy general manager of the Company. He is responsible for assisting the chairman in overall strategic planning and management and business development of the Group. Since 1993, Mr. Zhang has held various positions in Molong Holdings and the Group, including deputy general manager and deputy chairman of the Company. Mr. Zhang graduated from Nanjing University with a bachelor of laws degree and holds an advanced certificate in Training Course of Chinese Communist Party School for Entrepreneurs and was granted the "Excellent Private Enterpriser of Weifang City" in 2004. He has abundant experience in the development, manufacture and sales of petroleum machinery and the management of the Group. Mr. Zhang is the son of Zhang En Rong, an executive Director.

*Mr. Lin Fu Long (林福龍先生)*, aged 52, is a founder, an executive Director and the general manager of the Company. He is responsible for the overall management of the Group. Mr. Lin was deputy factory manager of Petroleum Machinery Parts Factory, Petroleum Machinery Factory and Weifang Molong from 1989 to 1993 and was deputy general manager of Molong Holdings from 1994 to 2001. Mr. Lin was awarded as an "Capable Sales Person" by the Shouguang City People's Government in 1994.

*Mr. Xie Xin Cang (謝新倉先生)*, aged 43, is a founder of the Company, an executive Director and the secretary to the Board. Mr. Xie joined Molong Holdings in 1995 as deputy general manager. During his employment, Mr. Xie has applied the nickel plating phosphorus alloy in the manufacturing of petroleum machinery and invented the "MB424 steel wire teasel" in 1998. Mr. Xie graduated from Xian Jiaotong University in mechanical engineering and specialised in metal studies and heat treatment. Mr. Xie was awarded the "Shandong Province Town and Village Enterprise Technology Innovation Leader" certificate by the Shandong Province Town and Village Enterprise Management Bureau in 1998. Mr. Xie is the husband of Ms. Li Bao Hui, a supervisor ("Supervisor") of the Company.



### Non-executive Directors

*Mr. Chen Jian Xiong (陳建雄先生)*, aged 49, is a non-executive Director. Mr. Chen has worked for Rodless Oil Pump Company of Shengli Petroleum Administration Bureau for over 10 years. Since 1994, Mr. Chen is the managing director of Shengli Oil Field Kaiyuan Oil Exploitation Company Limited ("Kaiyuan Oil") and was assistant manager and then the general manager of Rodless Oil Pump Company of Shengli Petroleum Administration Bureau. Mr. Chen was appointed as a non-executive Director on 29 March 2003.

*Mr. Wang Ping (王平先生)*, aged 49, is a non-executive Director. Mr. Wang has over 20 years of experience in metallurgy and received his doctorate degree in engineering from the University of Science and Technology Beijing. Since 2000, Mr. Wang is a professor at the University of Science and Technology of Beijing and was appointed as a non-executive Director on 29 March 2003.

### Independent non-executive Directors

*Mr. Qin Xue Chang (秦學昌先生)*, aged 39, is an independent non-executive Director. Mr. Qin has over 10 years of experience in accounting and auditing industry. He received his bachelor degree in economics from Shanxi University of Finance and Economics and is a practicing certified public accountant in the PRC. Mr. Qin is a deputy chairman of Beijing Yongtuo Certified Public Accountants Co., Ltd. and was appointed as an independent non-executive Director on 29 March 2003.

*Mr. Yan Yi Zhuang (閻翊莊先生)*, aged 47, is an independent non-executive Director. He is also a deputy operation manager of Shougang Concord Technology Holdings Ltd., a company listed on the main board of the Stock Exchange. Mr. Yan has over 10 years of experience in electronics technology and graduated from the University of Western Sydney, Australia. Mr. Yan was appointed as an independent non-executive Director on 29 March 2003.

*Mr. Loke Yu alias Loke Hoi Lam (陸海林先生)*, aged 55, is an independent non-executive Director. Mr. Loke has over 30 years of experience in accounting and auditing for private and public companies, consultancy and corporate management. He holds a MBA degree in Techno-entrepreneurship from University Teknologi Malaysia. Mr. Loke is a Fellow of The Institute of Chartered Accountants in England & Wales and a member of the Malaysian Institute of Accountants. He is also an associate member of The Institute of Chartered Secretaries & Administrators. Mr. Loke is a senior consultant with Morison Heng, Certified Public Accountants and was appointed as an independent non-executive Director on 20 March 2004.



## Supervisors

*Ms. Li Bao Hui (李寶惠女士)*, aged 41, is a Supervisor and the chairman of the supervisory committee of the Company (the “Supervisory Committee”). She is currently a quality control manager of the Company and works in the quality control department of Molong Holdings since 1995. She has over 10 years of experience in quality control and quality management and graduated from Shanxi Radio and Television University. Ms. Li is the wife of Xie Xin Cang, an executive Director, and was appointed as a Supervisor on 29 March 2003.

*Mr. Liu Wan Fu (劉萬賦先生)*, aged 66, is a Supervisor. Mr. Liu is a consultant of China National Petroleum Corporation. Mr. Liu has over 40 years of experience in the petroleum industry. Mr. Liu was appointed as a Supervisor on 29 March 2003.

*Mr. Fan Ren Yi (樊仁意先生)*, aged 39, is a Supervisor. Mr. Fan is the chief accountant of Shouguang Artex Group. Mr. Fan holds a bachelor degree from Xian Jiaotong University and is a certified public accountant in the PRC. Mr. Fan was appointed as a Supervisor on 29 March 2003.

## Senior Management

*Mr. Zhang Yu Zhi (張玉之先生)*, aged 46, is a deputy general manager of the Company. He is responsible for the sales of the Group. Mr. Zhang has over 10 years of experience in petroleum machinery industry. Before joining the Group, he was responsible for management of Weifang Transportation Company and Shouguang Shangkou Sales Agency. He joined the Group in October 1994, as general manager of its Xinjiang representative office, and has participated in the petroleum machinery industry since then.

*Ms. Qi Yan Ping (齊豔萍女士)*, aged 38, is a deputy general manager of the Company. She has over 16 years of experience in finance sector. Ms. Qi graduated from Shandong Institute of Architecture & Engineering. Before joining the Group, she worked at Shouguang branch of Construction Bank of China as a vice president and was responsible for credit and finance business. She joined the Company in September 2004 as a deputy general manager and is responsible for the overall financial management of the Group.

*Mr. Liu Yun Long (劉雲龍先生)*, aged 35, is a deputy general manager of the Company. Mr. Liu joined Molong Holdings in March 1990 after completing secondary studies. Mr. Liu is responsible for the export of large-size high pressure spherical valves to the US and the development of mud pump steel sleeves. Mr. Liu has significant experience in managing production of petroleum extraction machinery. He was awarded the “Modern Enterprise Personnel” certificate in 1993.

*Mr. Cui Huan You (崔煥友先生)*, aged 56, is the chief accountant of the Company. Mr. Cui has significant experience in finance, accounting and taxation. He joined Molong Holdings as an accounting supervisor in June 1995. He graduated from Shandong Province Financial Zhigong University. Mr. Cui was awarded the “Outstanding Financial Management Personnel” in 1992 and the “Advanced Accountant of Weifang City” in 2004.



*Mr. Liang Yong Qiang (梁永強先生)*, aged 36, is a deputy chief engineer of the Company. Mr. Liang joined Molong Holdings in July 2001. He graduated from Xian Jiaotong University. Mr. Liang participated in the development of certain models of oil well pumps and has won a second prize in the “Shandong Province Kuiwen District First Science and Technology Enhancement Contest”.

### Qualified Accountant and Company Secretary

*Mr. Chan Wing Nang, Billy (陳永能先生)*, aged 43, is the qualified accountant and company secretary of the Company. Mr. Chan graduated from the University of Newcastle upon Tyne, United Kingdom with a bachelor degree in Civil Engineering in 1986. He also read a master degree in business administration at the University of Warwick, United Kingdom. Mr. Chan is a member of the Hong Kong Institute of Certified Public Accountants and The Institute of Chartered Accountants in England and Wales. Mr. Chan has over 10 years of experience in the accounting and consulting field. Prior to joining the Group, Mr. Chan was a director in a consulting company. Mr. Chan joined the Group on 13 December 2004.



The board of Directors has the pleasure to present their annual report and the audited financial statements for the year ended 31 December 2004.

## Principal Activities

The Group is principally engaged in the design, manufacture and sale of oil well pumping machines, oil well sucker rods, oil well pumps, oil well pipes and other petroleum extraction machinery accessories.

## Results

The Group's profit for the year ended 31 December 2004 and the state of affairs of the Company and the Group at that date are set out in the financial statements on pages 32 to 64 of the annual report.

## Financial Summary

A summary of the results and of the assets and liabilities of the Group for the past four financial years is set out on page 5 of the annual report.

## Dividends

The board of Directors has resolved to recommend a final dividend of approximately RMB0.015 (inclusive of tax) for the year ended 31 December 2004. The proposal to declare and pay this final dividend will be submitted to the forthcoming annual general meeting to be held on 7 May 2005. Final dividend for domestic shares of the Company will be distributed and paid in RMB whereas dividend for H shares of the Company will be declared in RMB and paid in Hong Kong dollars. The H share registrar of the Company will be closed from 7 April 2005 to 6 May 2005 (both days inclusive) during which no transfer of H shares of the Company will be registered.

## Share Capital

The change(s) in share capital of the Company for the year ended 31 December 2004 is set out in note 25 to the financial statements.

## Reserves

Details of movements in the reserves of the Group and of the Company for the year ended 31 December 2004 are set out in note 26 to the financial statements.

## Property, Plant and Equipment

Details of movements in the property, plant and equipment of the Group for the year ended 31 December 2004 are set out in note 14 to the financial statements.

## Directors and Supervisors

The directors and supervisors of the Company during the year and up to the date of this report were:

### Executive Directors

Mr. Zhang En Rong  
Mr. Zhang Yun San  
Mr. Lin Fu Long  
Mr. Xie Xin Cang

### Non-executive Directors

Mr. Chen Jian Xiong  
Mr. Wang Ping

### Independent non-executive Directors

Mr. Qin Xue Chang  
Mr. Yan Yi Zhuang  
Mr. Loke Yu alias Loke Hoi Lam

### Supervisors

Ms. Li Bao Hui  
Mr. Liu Wan Fu  
Mr. Fan Ren Yi

## Directors' and Supervisors' Service Contracts

Each of the Directors and Supervisors (including the independent non-executive Directors and the Supervisors) has entered into a service contract with the Company for a term of three years. None of the Directors or the Supervisors had entered into any service contract with the Company which is not terminable by the Company within one year without payment of compensation, other than statutory compensation.

## Re-election of Director

The appointment of Mr. Chen Jian Xiong, a non-executive Director, ended on 27 December 2004. Pursuant to the articles of association of the Company, he was appointed as a non-executive Director by the board of Directors until the forthcoming annual general meeting of the Company to be held on 7 May 2005 ("AGM"). Mr. Chen Jian Xiong will offer himself for re-election as a non-executive Director at the AGM.

Mr. Chen Jian Xiong, aged 49, has worked for Rodless Oil Pump Company of Shengli Petroleum Administration Bureau for over 10 years. Since 1994, Mr. Chen is the managing director of Shengli Oil Field Kaiyuan Oil Exploitation Company Limited ("Kaiyuan Oil") and was assistant manager and then the general manager of Rodless Oil Pump Company of Shengli Petroleum Administration Bureau. Mr Chen was a Director since 28 December 2001 and was appointed as a non-executive Director on 29 March 2003. Save as disclosed above, Mr. Chen did not hold any directorship in other listed public companies in the past three years.



The proposed appointment of Mr. Chen is for a term of three years commencing from the passing of the relevant resolution at the AGM. No remuneration was paid to Mr. Chen for the year ended 31 December 2004 and no remuneration will be payable to Mr. Chen under his proposed appointment. Mr. Chen is and was not connected with any Directors, senior management or substantial or controlling shareholders of the Company. As at the date of this report, Mr. Chen does not have any interests in the shares, debentures or underlying shares of the Company within the meaning of Part XV of the Securities and Futures Ordinance.

Save as disclosed above, Mr. Chen has confirmed that there are no other matters that need to be brought to the attention of the Shareholders in connection with his re-election.

## Profile of Directors, Supervisors and Senior Management

Profile of Directors, Supervisors and senior management is set out on pages 16 to 19 of the annual report.

## Independent non-executive Directors

The Company has received from each of the independent non-executive Directors an annual confirmation of his independence pursuant to Rule 5.09 of the GEM Listing Rules and the Board still considers each of the independent non-executive Directors to be independent.

## Emoluments of Directors and Highest Paid Individuals

Details of emoluments of Directors and highest paid individuals are set out in notes 8 and 9 to the financial statements.

## Disclosure under GEM Listing Rules 17.15 to 17.21

Under the Chapter 17.15 of the GEM Listing Rules, the following disclosure obligation arises, among other situations, where any of the percentage ratios of the relevant advance to an entity from the issuer or any of its subsidiaries exceeds 8.0%.

Loans advanced, and guarantees given for facilities granted, to entities by the Group which individually exceeded 8.0% of the relevant percentage ratios under Rule 17.15 of the GEM Listing Rules as at 31 December 2004 are as follows:

### Advance to PetroChina

Trade receivables in the amount of approximately RMB47.8 million were owed from an independent party, PetroChina Company Limited ("PetroChina") and its subsidiaries as at 31 December 2004. Such receivables exceeded 8.0% of the relevant percentage ratio(s).

As confirmed by the Directors, the trade receivables referred to above were resulted from the sale of the Group's products to such customers in the ordinary course of business of the Group. The trade receivables were unsecured, interest free and had credit terms of between 30 to 150 days.

### Connected Transaction

The Company and Shouguang Molong Electro-mechanical Equipment Company Limited (壽光墨龍機電設備有限公司) ("Molong Equipment") entered into an agreement in relation to the supply of casting to the Company ("Casting Supply Agreement") on 20 March 2004 which took effect upon the listing of the H shares of the Company on GEM on 15 April 2004 and would remain in force up to 31 December 2006. Pursuant to the Casting Supply Agreement, Molong Equipment agreed to sell and the Company agreed to purchase casting. Molong Equipment and the Company may from time to time enter into contracts setting out the detailed terms for the supply of casting by Molong Equipment provided that such detailed terms shall not be inconsistent with the terms of the Casting Supply Agreement. The principal terms of the Casting Supply Agreement have been disclosed in the Prospectus.

Mr. Zhang Yun Qi, the son of Mr. Zhang En Rong and the brother of Mr. Zhang Yun San who are both Directors, is regarded as an associate of Directors and is therefore regarded as a connected person of the Company under the GEM Listing Rules. As Mr. Zhang Yun Qi is interested in approximately 53.15% of the equity interest in Maolong Machinery, Maolong Machinery is deemed to be a connected person of the Company by the Stock Exchange.

Maolong Machinery and Mr. Luke Fang is interested in 55.0% and 45.0% of the registered capital of Molong Equipment respectively. Mr. Fang is a third party independent of and not connected with any of the Directors, Supervisors, chief executives, substantial shareholders, management shareholders of the Company or its subsidiary or any of their respective associates. Given that Maolong Machinery is deemed to be a connected person of the Company by the Stock Exchange and that Molong Equipment is a subsidiary of Maolong Machinery, Molong Equipment is also deemed to be a connected person of the Company.

The Stock Exchange has granted a waiver to the Company from strict compliance with the requirement of rules 20.47 to 20.48 of the GEM Listing Rules in respect of the connected transaction set out above.

The independent non-executive Directors have reviewed the above connected transaction and confirmed that, in their opinions:

1. The transaction has been entered into in by the Company in the ordinary and usual course of their businesses;
2. The transaction has been entered into on normal commercial terms, or where there is no sufficient comparable transactions to judge whether they are on normal commercial terms, on terms no less favourable to the Company than those available to or from independent third parties;
3. The transaction is entered into in accordance with the terms of the agreement governing such transaction and on terms that are fair and reasonable and in the interests of the shareholders of the Company as a whole.





The auditors of the Company have reviewed such transaction and have provided a letter to the Company stating that:

1. The transaction had been approved by the board of Directors;
2. The transaction has been entered into in accordance with the pricing policies of the Group;
3. The transaction has been entered into in accordance with the relevant agreement governing such transaction;
4. The transaction has not exceeded the relevant annual limits as disclosed in the Prospectus.

### Retirement/Pension Scheme Benefits

	<b>2004</b>	2003
	<b>RMB'000</b>	RMB'000
Staff welfare (salaries)		
Wages and salaries	<b>16,675</b>	11,182
Contributions to retirement benefit schemes	<b>1,765</b>	1,416
Total	<b><u>18,440</u></b>	<u>12,598</u>

As stipulated by the laws, orders and regulations of the PRC, the Group participated in various defined contribution retirement plans organised by municipal governments for its staff. Currently, the Group is required to make contributions to the retirement plans at a rate of 15.0% (2003:15.0%) of the salaries, bonuses and certain allowances of its staff of last year. A member of the plan is entitled to a pension, to be paid by the municipal governments, equal to a fixed proportion of the salary prevailing at his retirement date. The Group has no other material obligation for the payment of pension benefits associated with these plans beyond the annual contributions described above.

## Disclosure of Directors' Interests in Shares

As at 31 December 2004, the interests and short positions of the Directors and any chief executives in the shares, underlying shares or debentures of the Company or any of its associated corporations (within the meaning of Part XV of the Securities and Futures Ordinance (the "SFO")), which will be required to be notified to the Company and the Stock Exchange pursuant to Divisions 7 and 8 of Part XV of the SFO (including interests or short positions which they are taken or deemed to have under such provisions of the SFO) or which will be required, pursuant to section 352 of the SFO, to be entered in the register referred to therein, or which will be required pursuant to Rules 5.46 to 5.68 of the GEM Listing Rules, to be notified to the Company and to the Stock Exchange, will be as follows:

### Long positions in shares of the Company

Name	Type of interest	Number of domestic shares	Percentage of domestic shares	Percentage of total registered share capital
Zhang En Rong	Personal	279,517,000	69.58%	51.76%
Lin Fu Long	Personal	34,216,000	8.52%	6.34%
Zhang Yun San	Personal	30,608,000	7.62%	5.67%
Xie Xin Cang	Personal	21,410,000	5.33%	3.96%

Other than as disclosed above, none of the Directors and chief executives had any interests or short position in shares, underlying shares or debentures of the Company or any of its associated corporations (within the meaning of Part XV of the SFO), will have to be notified to the Company and the Stock Exchange under Divisions 7 and 8 of Part XV of the SFO (including interests and short positions which they are taken or deemed to have under the SFO) or will be required pursuant to the required standard of dealings by Directors as referred to in Rule 5.46 to 5.68 of the GEM Listing Rules or section 352 of the SFO to be entered in the register of interests referred to therein.

### Directors' and Supervisors' Rights to Acquire Shares or Debentures

None of the Directors or Supervisors or their respective associates (as defined under the GEM Listing Rules) was granted by the Company or its subsidiaries any rights or options to acquire any shares in or debentures of the Company or had exercised any such rights as at 31 December 2004.

### Share Option Scheme

The Company does not have any share option scheme.

## Substantial Shareholders

As at 31 December 2004, so far as the Directors are aware, the following persons (other than Directors or chief executives of the Company) had interests or short positions in the shares and underlying shares and debentures of the Company which would fall to be disclosed to the Company under the provisions of Divisions 2 and 3 of Part XV of the SFO and required to be recorded in the register to be kept under section 336 of the SFO:

### Long positions in shares

Name	Type of interests	Number of shares	Percentage of domestic shares	Percentage of H shares	Percentage of total registered capital
Zhang Xiu Lan (Note 1)	Interests of spouse	279,517,000	69.58%	—	51.76%
Li Xiu Fen (Note 2)	Interests of spouse	34,216,000	8.52%	—	6.34%
Zhang Xin Lan (Note 3)	Interests of spouse	30,608,000	7.62%	—	5.67%
Li Bao Hui (Note 4)	Interests of spouse	21,410,000	5.33%	—	3.96%
Martin Currie Investment Management Limited (Note 5)	Investment manager	15,696,000	—	11.36%	2.91%
Martin Currie China Hedge Fund Limited (Note 5)	Investment manager	12,264,000	—	8.87%	2.27%
UBS AG (Note 5)	Investment manager	12,264,000	—	8.87%	2.27%
Peter Cundill & Associates (Bermuda) Ltd. (Note 5)	Investment manager	63,700,000	—	46.07%	11.80%

Note 1: Zhang Xiu Lan is the wife of Zhang En Rong and is taken to be interested in the 279,517,000 domestic shares held by Zhang En Rong under the SFO.

Note 2: Li Xiu Fen is the wife of Lin Fu Long and is taken to be interested in the 34,216,000 domestic shares held by Lin Fu Long under the SFO.

Note 3: Zhang Xin Lan is the wife of Zhang Yun San and is taken to be interested in the 30,608,000 domestic shares held by Zhang Yun San under the SFO.

Note 4: Li Bao Hui is the wife of Xie Xin Cang and is taken to be interested in the 21,410,000 domestic shares held by Xie Xin Cang under the SFO.

Note 5: Interests in H shares.

Save as disclosed above, so far as the Directors are aware, there are no other persons not being a Director or chief executive of the Company who had interests or short positions in the shares and underlying shares and debentures of the Company which would fall to be disclosed to the Company under the provisions of Divisions 2 and 3 of Part XV of the SFO and required to be recorded in the register required to be kept under section 336 of the SFO.

### Directors' Interests in Contracts

There were no contracts of significance to which the Company or any of its subsidiaries was a party and in which any of the Directors had a material interest, whether directly or indirectly, subsisted at the end of the year or at any time during the year.

### Corporate Governance

The Company has complied throughout the period under review with the provisions on board practice and procedures in the GEM Listing Rules, which was substantially revised with effect from 1 January 2005. Subject to the transitional arrangements, the Company will comply with the revised GEM Listing Rules, in particular, the Code on Corporate Governance Practices set out in Appendix 15 of the GEM Listing Rules, from the financial year commencing on 1 January 2005.

### Competing Interests

None of the Directors or the management shareholders of the Company and their respective associates (as defined in the GEM Listing Rules) had any interest in a business which competes or may compete with the business of the Group.

### Compliance Adviser's Interest

As updated and notified by the Company's Compliance Adviser, Deloitte & Touche Corporate Finance Limited (the "Compliance Adviser"), neither the Compliance Adviser, nor its directors, employees or associates (as defined under the GEM Listing Rules) had any interest in the share capital of the Company as at 31 December 2004 pursuant to Rule 6.36 of the GEM Listing Rules.

Pursuant to an agreement dated 29 March 2004 entered into between the Company and the Compliance Adviser, the Compliance Adviser will receive a fee for acting as the Company's retained sponsor for the period from 15 April 2004 to 31 December 2006 or until the agreement is terminated in accordance with the terms and conditions set out therein.



## Audit Committee

The Company established an audit committee on 20 March 2004 with written terms of reference in compliance with the requirements as set out in Rules 5.28 and 5.29 of the GEM Listing Rules. The primary duties of the audit committee are to review and provide supervision over the financial reporting procedures and internal control system of the Group. The audit committee comprises the three independent non-executive Directors, namely Mr. Qin Xue Chang, Mr. Yan Yi Zhuang and Mr. Loke Yu alias Loke Hoi Lam. Mr. Qin Xue Chang is the chairman of the audit committee.

The audit committee has reviewed with the management the accounting principles and practices adopted by the Group and discussed internal controls and financial reporting matters, including a review of the audited results of the Group for the year ended 31 December 2004.

## Code of Conduct Regarding Securities Transactions by Directors

During the year ended 31 December 2004, the Company had adopted a code of conduct regarding securities transactions by Directors on terms no less exacting than the required standard of dealings set out in Rules 5.48 to 5.67 of the GEM Listing Rules. The Company had also made specific enquiry with all Directors and the Company was not aware of any non-compliance with the required standard of dealings and its code of conduct regarding securities transactions by directors.

## Major Customers and Suppliers

During the reporting period, the Group's products are mainly sold to domestic oilfields within the PRC. In addition, the Group also sold its products to customers in the United States, the United Kingdom, etc. and has further explored the markets in Europe and East Asia.

During the period under review, the Group's major suppliers are reputable special steel producers in the PRC, with whom the Group has established good relationships. During the year under review, as the Group successfully extended the production chain of oil well pipes, one of our main products, namely, continuous casting pipe billet, replaced hollow blade as our principal raw materials. The largest supplier was changed from Changzhou Baogang Steel Pipe Company Limited (常州寶鋼鋼管有限公司) to Dongbei Special Steel Holding Company Limited (東北特鋼集團有限公司), which the Company has signed strategic co-operation agreement with.

For the year ended 31 December, 2004, the five largest customers accounted for approximately 94.5% of the Group's total turnover and the five largest suppliers of the Group accounted for approximately 51.2% of the Group's total purchases. The largest customer of the Group accounted for approximately 55.2% of the Group's total turnover, while the largest supplier accounted for approximately 22.1% of the Group's total purchases.

Save as disclosed above, none of the Directors, Supervisors, their associates or any shareholders of the Company (who or which to the knowledge of the Directors own more than 5.0% of the share capital of the Company) has any beneficial interest in any of the Group's five largest customers and suppliers.

### Purchase, Sale or Redemption of Securities

Neither the Company nor its subsidiary has purchased, sold or redeemed any listed securities of the Company during the year ended 31 December 2004.

### Pre-emptive rights

There is no provision for pre-emptive rights under the articles of association of the Company or the laws of the PRC which would oblige the Company to offer new shares on a pro rata basis to existing shareholders.

### Auditors

The accounts have been audited by Ernst & Young who will retire and will offer themselves for re-appointment. A resolution for their re-appointment as auditors of the Company will be proposed at the forthcoming annual general meeting.

On behalf of the Board

**Zhang En Rong**

Chairman

Shandong, the PRC

16 March 2005



To the Shareholders:

The supervisory committee (the "Supervisory Committee") of Shandong Molong Petroleum Machinery Company Limited, in compliance with the provisions of the Company Law of the People's Republic of China (the "PRC Company Law"), the relevant laws and regulations of Hong Kong and the articles of association of the Company, has conducted its work in accordance with the fiduciary principle, and has taken up an active role to work faithfully and diligently to protect the interests of the Company and the Shareholders.

During the year under review, the Supervisory Committee had reviewed cautiously the development plans of the Company and provided reasonable suggestions and opinions to the board of Directors. It also strictly and effectively monitored and supervised the Company's management in making significant policies and decisions by attending board meetings to ensure that they are in compliance with the laws and regulations of the PRC and the articles of association of the Company, and in the interests of the Shareholders.

We have carefully reviewed and agreed to the report of the Directors, audited financial statements and the declaration of a final dividend to be proposed by the Board for presentation at the forthcoming annual general meeting. The Supervisors believe that during the reporting period, the operating results of the Company adequately reflects its state of affairs; all expenses and costs incurred were reasonable; the plan for distribution of dividends accommodated the Shareholders' interests and the long-term benefits of the Company and the statutory surplus reserve and welfare fund provided from net profits for the year were made in compliance with applicable laws, regulations and the articles of association of the Company.

Throughout the period under review, to the best knowledge of the Supervisory Committee, none of the Directors or other officers of the Company had been found to have abused their authority, damaged the interests of the Company or infringed upon the interest of the Shareholders and the Company's employees. To the best knowledge of the Supervisory Committee, none of the Directors or other officers of the Company was found to be in breach of any applicable laws and regulations, the articles of association of the Company or relevant regulations of China Securities Regulatory Commission. We are of the opinion that the Directors and other officers of the Company were able to strictly observe their respective duties, to act diligently and to exercise their authority faithfully in the best interests of the Company.

The Supervisory Committee is satisfied with the achievement and cost-effectiveness of the Company for the year ended 31 December 2004 and has great confidence in the future of the Company and would like to take this opportunity to extend its appreciation to all Shareholders, Directors and staff for the strong support of our work.

By order of the Supervisory Committee

**Li Bao Hui**

Chairman of the Supervisory Committee

16 March 2005



■ **Certified Public Accountants**  
15/F Hutchison House,  
10 Harcourt Road,  
Central, Hong Kong

■ Phone: 852 2846 9888  
852 2526 5371  
Fax: 852 2868 4432  
852 2845 9208

To the members

## **Shandong Molong Petroleum Machinery Company Limited**

(Incorporated in the People's Republic of China with limited liability)

We have audited the financial statements on pages 32 to 64 which have been prepared in accordance with accounting principles generally accepted in Hong Kong.

### **Respective responsibilities of directors and auditors**

The Company's directors are responsible for the preparation of financial statements which give a true and fair view. In preparing financial statements which give a true and fair view it is fundamental that appropriate accounting policies are selected and applied consistently. It is our responsibility to form an independent opinion, based on our audit, on those financial statements and to report our opinion solely to you, as a body, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

### **Basis of opinion**

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

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

### **Opinion**

In our opinion the financial statements give a true and fair view of the state of affairs of the Company and of the Group as at 31 December 2004 and of the profit and cash flows of the Group for the year then ended and have been properly prepared in accordance with the disclosure requirements of the Hong Kong Companies Ordinance.

**Ernst & Young**

Hong Kong

16 March 2005



# Consolidated Profit and Loss Account



Year ended 31 December 2004

	Notes	2004 RMB'000	2003 RMB'000
TURNOVER	5	487,688	302,274
Cost of sales		(391,030)	(226,872)
Gross profit		96,658	75,402
Other revenue and gains	5	15,458	21,995
Selling and distribution costs		(20,128)	(11,299)
Administrative expenses		(14,300)	(11,099)
Other operating expenses		(7,540)	(10,914)
PROFIT FROM OPERATING ACTIVITIES	6	70,148	64,085
Finance costs	7	(4,572)	(4,738)
PROFIT BEFORE TAX		65,576	59,347
Tax	10	(1,485)	(13,197)
PROFIT BEFORE MINORITY INTERESTS		64,091	46,150
Minority interests		(2,725)	(2,173)
NET PROFIT FROM ORDINARY ACTIVITIES ATTRIBUTABLE TO SHAREHOLDERS	11	61,366	43,977
DIVIDENDS	12		
Interim		10,806	—
Proposed final		8,100	—
		18,906	—
EARNINGS PER SHARE – Basic	13	RMB0.122	RMB0.109

# Consolidated Balance Sheet



31 December 2004

	Notes	2004 RMB'000	2003 RMB'000
<b>NON-CURRENT ASSETS</b>			
Fixed assets	14	133,458	87,043
Intangible asset	15	112	—
Long term investments	17	50	6,050
		<b>133,620</b>	<b>93,093</b>
<b>CURRENT ASSETS</b>			
Inventories	18	140,284	67,985
Trade receivables	19	89,871	55,319
Notes receivables		—	4,500
Other receivables	20	15,321	54,871
Due from related parties	31(ii)	—	10,429
Pledged deposits	21	61,886	34,072
Cash and cash equivalents	21	26,077	63,087
		<b>333,439</b>	<b>290,263</b>
<b>CURRENT LIABILITIES</b>			
Trade and bills payables	22	169,096	120,321
Other payables and accruals	23	20,206	47,256
Tax payable		302	6,880
Interest-bearing bank loans	24	30,000	65,000
Due to related parties	31(i)	811	—
		<b>220,415</b>	<b>239,457</b>
<b>NET CURRENT ASSETS</b>			
		<b>113,024</b>	<b>50,806</b>
<b>TOTAL ASSETS LESS CURRENT LIABILITIES</b>			
		<b>246,644</b>	<b>143,899</b>
<b>NON-CURRENT LIABILITIES</b>			
Interest-bearing bank loans	24	—	25,000
<b>MINORITY INTERESTS</b>			
		<b>1,090</b>	<b>4,814</b>
		<b>245,554</b>	<b>114,085</b>
<b>CAPITAL AND RESERVES</b>			
Issued capital	25	54,000	40,500
Reserves	26(a)	183,454	73,585
Proposed final dividend	12	8,100	—
		<b>245,554</b>	<b>114,085</b>

Zhang Yun San  
Director

Xie Xin Cang  
Director

# Consolidated Statement of Changes in Equity



Year ended 31 December 2004

	Notes	Issued share capital RMB'000	Capital reserve RMB'000	Statutory reserve fund* RMB'000	Statutory welfare fund* RMB'000	Enterprise expansion fund RMB'000	Retained earnings RMB'000	Subtotal of reserves RMB'000	Proposed final dividend RMB'000	Total RMB'000
At 1 January 2003		40,500	21,278	3,476	2,322	10	2,522	29,608	—	70,108
Net profit for the year		—	—	—	—	—	43,977	43,977	—	43,977
Transfer from retained earnings to statutory funds		—	—	4,107	2,058	—	(6,165)	—	—	—
Written back on disposal		—	(651)	—	(10)	(10)	671	—	—	—
At 31 December 2003		40,500	20,627	7,583	4,370	—	41,005	73,585	—	114,085
Issue of new shares	25	13,500	89,169	—	—	—	—	89,169	—	102,669
Share issue expenses	25	—	(21,760)	—	—	—	—	(21,760)	—	(21,760)
Net profit for the year		—	—	—	—	—	61,366	61,366	—	61,366
Transfer from retained earnings to statutory funds		—	—	8,456	3,649	—	(12,105)	—	—	—
Interim 2004 dividend	12	—	—	—	—	—	(10,806)	(10,806)	—	(10,806)
Proposed final 2004 dividend	12	—	—	—	—	—	(8,100)	(8,100)	8,100	—
At 31 December 2004		54,000	88,036	16,039	8,019	—	71,360	183,454	8,100	245,554

\* The Company and its subsidiaries are required to follow the laws and regulations of the PRC and their articles of association to provide for certain statutory funds, namely the statutory reserve fund and the statutory welfare fund, which are appropriated from net profit after tax, but before dividend distribution at the discretion of their board of directors on at least 10% and 5% of net profit, respectively. The statutory reserve fund is provided for each entity until the balance of such fund has reached 50% of the entity's registered capital. The statutory reserve fund may only be used, upon approval by the relevant authority, to offset accumulated losses or to increase capital. The statutory welfare fund is only permitted to be used for special bonuses or for the collective welfare of the employees. Assets acquired through this fund are not treated as assets of the Group.

# Consolidated Cash Flow Statement



Year ended 31 December 2004

	Notes	2004 RMB'000	2003 RMB'000
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>			
Profit before tax		<b>65,576</b>	59,347
Adjustments for:			
Finance costs	7	<b>4,572</b>	4,738
Investment income from a trust investment	5	<b>(289)</b>	—
Interest income	5	<b>(1,029)</b>	(893)
Gain on disposal of fixed assets	5	<b>(102)</b>	—
Amortisation of an intangible asset	6,15	<b>8</b>	—
Gain on disposal of subsidiaries	5	—	(2,658)
Loss on disposal of an associate		—	14
Depreciation	6	<b>9,169</b>	5,943
Operating profit before working capital changes		<b>77,905</b>	66,491
Increase in inventories		<b>(72,299)</b>	(11,257)
Increase in trade receivables		<b>(34,552)</b>	(14,860)
(Increase)/decrease in notes receivables		<b>4,500</b>	(4,339)
(Increase)/decrease in other receivables		<b>39,550</b>	(37,605)
(Increase)/decrease in amounts due from related parties		<b>10,429</b>	(39)
Increase in trade and bills payables		<b>48,775</b>	38,760
Increase/(decrease) in other payables and accruals		<b>(27,050)</b>	10,304
Decrease in an amount due to an associate		—	(61)
Increase in amounts due to related parties		<b>811</b>	3,584
Cash generated from operations		<b>48,069</b>	50,978
Interest paid		<b>(4,572)</b>	(4,738)
PRC tax paid		<b>(8,063)</b>	(4,835)
Dividend paid		—	(5,469)
Net cash inflow from operating activities		<b>35,434</b>	35,936

# Consolidated Cash Flow Statement



Year ended 31 December 2004

	Notes	2004 RMB'000	2003 RMB'000
Net cash inflow from operating activities		35,434	35,936
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>			
Investment income from a trust investment		289	—
Interest received		1,016	893
Purchases of fixed assets	14	(55,772)	(53,568)
Purchases of an intangible asset	15	(120)	—
Proceeds from disposal of fixed assets		290	1,387
Proceeds from disposal of a long term investment		6,000	—
Proceeds from disposal of an associate		—	1,666
Disposal of a subsidiary		—	22,566
Purchase of a long term investment		—	(6,000)
Loans to related companies		—	17,240
Increase in pledged time deposits		(30,435)	—
Net cash outflow from investing activities		(78,732)	(15,816)
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>			
Proceeds from issue of shares	25	102,669	—
Share issue expenses	25	(21,760)	—
Capital contributed by a minority shareholder		600	—
New bank loans		38,000	100,000
Repayment of bank loans		(98,000)	(86,700)
Dividends paid	12	(10,806)	—
Dividends paid to a minority shareholder		(4,559)	—
Distribution of minority interests		(2,477)	—
Net cash inflow from financing activities		3,667	13,300
<b>NET INCREASE/(DECREASE) IN CASH AND CASH EQUIVALENTS</b>			
Cash and cash equivalents at beginning of year		97,159	63,739
<b>CASH AND CASH EQUIVALENTS AT END OF YEAR</b>			
<b>ANALYSIS OF BALANCES OF CASH AND CASH EQUIVALENTS</b>			
Cash and bank balances	21	26,077	63,087
Time deposits with original maturity of less than three months when acquired, pledged as security for bills payable		31,451	34,072
		<b>57,528</b>	<b>97,159</b>

# Balance Sheet



31 December 2004

	Notes	2004 RMB'000	2003 RMB'000
<b>NON-CURRENT ASSETS</b>			
Fixed assets	14	126,783	69,925
Interests in subsidiaries	16	24,852	7,450
Intangible asset	15	112	—
Long term investments	17	50	6,050
		<b>151,797</b>	83,425
<b>CURRENT ASSETS</b>			
Inventories	18	115,180	22,627
Trade receivables	19	89,871	33,140
Notes receivables		—	4,200
Other receivables	20	15,281	52,618
Tax recoverable		—	1,842
Due from related parties		—	2,260
Pledged deposits	21	61,886	34,072
Cash and cash equivalents	21	25,837	42,981
		<b>308,055</b>	193,740
<b>CURRENT LIABILITIES</b>			
Trade and bills payables	22	166,020	109,377
Other payables and accruals	23	22,245	12,896
Tax payable		302	—
Interest-bearing bank loans	24	30,000	65,000
Due to subsidiaries		—	8,554
Due to related parties		138	—
		<b>218,705</b>	195,827
<b>NET CURRENT ASSETS/(LIABILITIES)</b>			
		<b>89,350</b>	(2,087)
<b>TOTAL ASSETS LESS CURRENT LIABILITIES</b>			
		<b>241,147</b>	81,338
<b>NON-CURRENT LIABILITIES</b>			
Interest-bearing bank loans	24	—	25,000
		<b>241,147</b>	56,338
<b>CAPITAL AND RESERVES</b>			
Issued capital	25	54,000	40,500
Reserves	26(b)	179,047	15,838
Proposed final dividend	12	8,100	—
		<b>241,147</b>	56,338

Zhang Yun San  
Director

Xie Xin Cang  
Director

31 December 2004

## 1. CORPORATE INFORMATION

The registered office of Shandong Molong Petroleum Machinery Company Limited is located at No. 99 Beihai Road, Shouguang City, Shandong Province, the People's Republic of China (the "PRC").

During the year, the Group was involved in the design, manufacture and sale of petroleum extraction machinery and related accessories, which included oil well pipes, oil well sucker rods, oil well pumps and oil well pumping machines.

## 2. IMPACT OF RECENTLY ISSUED HONG KONG FINANCIAL REPORTING STANDARDS ("HKFRSs")

The Hong Kong Institute of Certified Public Accountants has issued a number of new and revised Hong Kong Financial Reporting Standards and Hong Kong Accounting Standards, herein collectively referred to as the new HKFRSs, which are generally effective for accounting periods beginning on or after 1 January 2005. The Group has not early adopted these new HKFRSs in the financial statements for the year ended 31 December 2004.

The Group had already commenced an assessment of the impact of these new HKFRSs but is not yet in a position to state whether these new HKFRSs would have a significant impact on its results of operations and financial position.

## 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### Basis of preparation

These financial statements have been prepared in accordance with Hong Kong Financial Reporting Standards (which also include Statements of Standard Accounting Practice and Interpretations) issued by the Hong Kong Institute of Certified Public Accountants, accounting principles generally accepted in Hong Kong and the disclosure requirements of the Hong Kong Companies Ordinance. They have been prepared under the historical cost convention, except for the remeasurement of certain equity investment as further explained below.

### Basis of consolidation

The consolidated financial statements include the financial statements of the Company and its subsidiaries for the year ended 31 December 2004. The results of subsidiaries acquired or disposed of during the year are consolidated from or to their effective dates of acquisition or disposal, respectively. All significant inter company transactions and balances within the Group are eliminated on consolidation.

Minority interests represent the interests of outside shareholders in the results and net assets of the Company's subsidiaries.

### Subsidiaries

A subsidiary is a company whose financial and operating policies the Company controls, directly or indirectly, so as to obtain benefits from its activities.

The results of subsidiaries are included in the Company's profit and loss account to the extent of dividends received and receivable. The Company's interests in subsidiaries are stated at cost less any impairment losses.

31 December 2004

### 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (*continued*)

#### Associates

An associate is a company, not being a subsidiary or a jointly-controlled entity, in which the Group has a long term interest of generally not less than 20% of the equity voting rights and over which it is in a position to exercise significant influence.

The Group's share of the post-acquisition results and reserves of associates is included in the consolidated profit and loss account and consolidated reserves, respectively. The Group's interests in associates are stated in the consolidated balance sheet at the Group's share of net assets under the equity method of accounting, less any impairment losses.

The results of associates are included in the Company's profit and loss account to the extent of dividends received and receivable. The Company's interests in associates are treated as long term assets and are stated at cost less any impairment losses.

#### Related parties

Parties are considered to be related if one party has the ability, directly or indirectly, to control the other party or exercise significant influence over the other party in making financial and operating decisions. Parties are also considered to be related if they are subject to common control or common significant influence. Related parties may be individuals or corporate entities.

#### Impairment of assets

An assessment is made at each balance sheet date of whether there is any indication of impairment of any asset, or whether there is any indication that an impairment loss previously recognised for an asset in prior years may no longer exist or may have decreased. If any such indication exists, the asset's recoverable amount is estimated. An asset's recoverable amount is calculated as the higher of the asset's value in use and its net selling price.

An impairment loss is recognised only if the carrying amount of an asset exceeds its recoverable amount. An impairment loss is charged to the profit and loss account in the period in which it arises.

A previously recognised impairment loss is reversed only if there has been a change in the estimates used to determine the recoverable amount of an asset, however not to an amount higher than the carrying amount that would have been determined (net of any depreciation/amortisation), had no impairment loss been recognised for the asset in prior years. A reversal of an impairment loss is credited to the profit and loss account in the period in which it arises.



31 December 2004

### 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (*continue*)

#### Fixed assets and depreciation

Fixed assets, other than construction in progress, are stated at cost less accumulated depreciation and any impairment losses. The cost of an asset comprises its purchase price and any directly attributable costs of bringing the asset to its working condition and location for its intended use. Expenditure incurred after fixed assets have been put into operation, such as repairs and maintenance, is normally charged to the profit and loss account in the period in which it is incurred. In situations where it can be clearly demonstrated that the expenditure has resulted in an increase in the future economic benefits expected to be obtained from the use of the fixed asset, the expenditure is capitalised as an additional cost of that asset.

Depreciation is calculated on the straight-line basis to write off the cost of each asset over its estimated useful life after taking into account its estimated residual value. The estimated useful lives of fixed assets are as follows:

Leasehold land and buildings	20 years to 40 years
Plant and machinery	10 years
Electronic equipment	5 years
Motor vehicles	5 years
Other equipment	5 years

The gain or loss on disposal or retirement of a fixed asset recognised in the profit and loss account is the difference between the net sales proceeds and the carrying amount of the relevant asset.

Construction in progress represents the assets incurred under construction, and is stated at cost less any impairment losses, and is not depreciated. Cost comprises the direct costs incurred during the period of construction, installation and testing. Construction in progress is reclassified to the appropriate category of fixed assets when completed and ready for use.

#### Intangible asset

##### *Know-how*

Purchased know-how is stated at cost less any impairment losses and is amortised on the straight-line basis over its estimated useful lives of five years.

##### *Research and development costs*

All research costs are charged to the profit and loss account as incurred.

31 December 2004

### 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (*continued*)

#### Operating leases

Leases where substantially all the rewards and risks of ownership of assets remain with the lessor are accounted for as operating leases. Where the Group is the lessor, assets leased by the Group under operating leases are included in non-current assets, and rentals receivable under the operating leases are credited to the profit and loss account on the straight-line basis over the lease terms. Where the Group is the lessee, rentals payable under the operating leases are charged to the profit and loss account on the straight-line basis over the lease terms.

#### Long term investments

Long term investments are non-trading investments in listed and unlisted equity securities intended to be held on a long term basis.

Listed securities are stated at their fair values on the basis of their quoted market prices at the balance sheet date, on an individual investment basis. Unlisted securities are stated at their estimated fair values, on an individual basis. The estimated fair values of unlisted investments are determined by the directors having regard to, inter alia, the prices of the most recent reported sales or purchases of the securities, or comparison of price/earnings ratios and dividend yields of the securities with those of similar listed securities, with allowance made for the lower liquidity of the unlisted securities.

The gains or losses arising from changes in the fair value of a security are dealt with as movements in the long term investment revaluation reserve, until the security is sold, collected, or otherwise disposed of, or until the security is determined to be impaired, when the cumulative gain or loss derived from the security recognised in the long term investment revaluation reserve, together with the amount of any further impairment, is charged to the profit and loss account in the period in which the impairment arises.

#### Inventories

Inventories are stated at the lower of cost and net realisable value. Cost is determined on the weighted average basis and, in the case of work in progress and finished goods, comprises direct materials, direct labour and an appropriate proportion of overheads. Net realisable value is based on estimated selling prices less any estimated costs to be incurred to completion and disposal.

#### Cash and cash equivalents

For the purpose of the consolidated cash flow statement, cash and cash equivalents comprise cash on hand and demand deposits, and short term highly liquid investments which are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value, and have a short maturity of generally within three months when acquired, less bank overdrafts which are repayable on demand and form an integral part of the Group's cash management.

For the purpose of the balance sheet, cash and cash equivalents comprise cash on hand and at banks, including term deposits, which are not restricted as to use.

31 December 2004

### 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (*continued*)

#### Income tax

Income tax comprises current and deferred tax. Income tax is recognised in the profit and loss account, or in equity if it relates to items that are recognised in the same or a different period directly in equity.

Deferred tax is provided, using the liability method, on all temporary differences at the balance sheet date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes.

Deferred tax liabilities are recognised for all taxable temporary differences:

- except where the deferred tax liability arises from the initial recognition of an asset or liability and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and
- in respect of taxable temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, except where the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future.

Deferred tax assets are recognised for all deductible temporary differences, carryforward of unused tax assets and unused tax losses, to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, and the carryforward of unused tax assets and unused tax losses can be utilised:

- except where the deferred tax asset relating to the deductible temporary differences arises from the initial recognition of an asset or liability and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and
- in respect of deductible temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, deferred tax assets are only recognised to the extent that it is probable that the temporary differences will reverse in the foreseeable future and taxable profit will be available against which the temporary differences can be utilised.

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 profit will be available to allow all or part of the deferred tax asset to be utilised. Conversely, previously unrecognised deferred tax assets are recognised to the extent that it is probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilised.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted at the balance sheet date.

#### Government grants and subsidies

Government grants and subsidies from the government are recognized at their fair values where there is reasonable assurance that the grant or subsidy will be received and all attaching conditions will be complied with. When the grant or subsidy relates to an expense item, it is recognised as income over the periods necessary to match the grant or subsidy on a systematic basis to the costs that it is intended to compensate. When the grant or subsidy relates to an assets, the fair value of the grant or subsidy is deducted from the carrying amount of the asset and released to the profit and loss account by way of a reduced depreciation charge.

31 December 2004

## 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (*continued*)

### Revenue recognition

Revenue is recognised when it is probable that the economic benefits will flow to the Group and when the revenue can be measured reliably, on the following bases:

- (a) from the sale of goods, when the significant risks and rewards of ownership have been transferred to the buyer, provided that the Group maintains neither managerial involvement to the degree usually associated with ownership, nor effective control over the goods sold;
- (b) rental income, on a time proportion basis over the lease terms;
- (c) dividend income, when the shareholders' right to receive payment has been established;
- (d) interest income, on a time proportion basis taking into account the principal outstanding and the effective interest rates applicable; and
- (e) value added tax refunds, when the acknowledgment of a refund from the tax bureau has been received.

### Retirement benefits costs

The Company and the subsidiaries comprising the Group operating in the PRC participate in the central pension scheme (the "CPS") operated by the PRC government for all of its staff. The Company and its PRC subsidiaries are required to contribute a certain percentage of their covered payroll to the CPS to fund the benefits. The only obligation of the Group with respect to the CPS is to pay the ongoing required contributions under the CPS. Contributions under the CPS are charged to the profit and loss account as they become payable in accordance with the rules of the CPS.

### Borrowing costs

Borrowing costs directly attributable to the acquisition, construction or production of qualifying assets, i.e. assets that necessarily take a substantial period of time to get ready for their intended use or sale, are capitalised as part of the cost of those assets. The capitalisation of such borrowing costs ceases when the assets are substantially ready for their intended use or sale. Investment income earned on the temporary investment of specific borrowings pending their expenditure on qualifying assets is deducted from the borrowing costs capitalised.

### Dividends

Final dividends proposed by the directors are classified as a separate allocation of retained earnings within the capital and reserves section of the balance sheet, until they have been approved by the shareholders in a general meeting. When these dividends have been approved by the shareholders and declared, they are recognised as a liability.

Interim dividends are simultaneously proposed and declared, because the Company's memorandum and articles of association grant the directors the authority to declare interim dividends. Consequently, interim dividends are recognised immediately as a liability when they are proposed and declared.

### Foreign currencies

Foreign currency transactions are recorded at the applicable exchange rates ruling at the transaction dates. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated at the applicable exchange rates ruling at that date. Exchange differences are dealt with in the profit and loss account.

31 December 2004

#### 4. SEGMENT INFORMATION

Segment information is presented by way of the Group's primary segment reporting basis, by geographical segment. The Group's operating business is with customers based in the PRC, the United States, and other countries. Each of the Group's geographical segments represents customer destinations to which the Group sells products or provides services which are subject to risks and returns that are different from those of the other geographical segments. No further business segment information is presented as over 90% of the Group's operations relate solely to the sale of petroleum machinery.

In determining the Group's geographical segments, assets are attributed to the segments based on the location of the assets instead of the location of the customers.

Intersegment sales and transfers are transacted with reference to the selling prices used for sales made to third parties at the then prevailing market prices.

The following table presents revenue, profit and certain asset, liability and expenditure information for the Group's geographical segments.

Group	PRC		United States		Unallocated		Consolidated	
	2004 RMB'000	2003 RMB'000	2004 RMB'000	2003 RMB'000	2004 RMB'000	2003 RMB'000	2004 RMB'000	2003 RMB'000
Segment revenue:								
Sales to external customers	398,351	256,478	52,052	42,972	37,285	2,824	487,688	302,274
Other revenue	1,768	4,593	—	—	—	—	1,768	4,593
Total	<u>400,119</u>	<u>261,071</u>	<u>52,052</u>	<u>42,972</u>	<u>37,285</u>	<u>2,824</u>	<u>489,456</u>	<u>306,867</u>
Segment results	<u>96,204</u>	<u>53,159</u>	<u>11,536</u>	<u>12,303</u>	<u>4,907</u>	<u>491</u>	<u>112,647</u>	<u>65,953</u>
Unallocated income (a)							13,690	17,402
Unallocated expenses (a)							(56,189)	(19,270)
Profit from operating activities							70,148	64,085
Finance costs							(4,572)	(4,738)
Profit before tax							65,576	59,347
Tax							(1,485)	(13,197)
Profit before minority interests							64,091	46,150
Minority interests							(2,725)	(2,173)
Net profit from ordinary activities attributable to shareholders							<u>61,366</u>	<u>43,977</u>

(a) Mainly represent sundry revenue and corporate expenses, as well as the depreciation of fixed assets.

31 December 2004

## 4. SEGMENT INFORMATION (continued)

Group

	PRC		United States		Unallocated		Consolidated	
	2004 RMB'000	2003 RMB'000	2004 RMB'000	2003 RMB'000	2004 RMB'000	2003 RMB'000	2004 RMB'000	2003 RMB'000
Segment assets	<u>448,916</u>	<u>383,356</u>	<u>17,269</u>	<u>—</u>	<u>874</u>	<u>—</u>	<u>467,059</u>	<u>383,356</u>
Total assets							<u>467,059</u>	<u>383,356</u>
Segment liabilities	<u>210,416</u>	<u>264,457</u>	<u>—</u>	<u>—</u>	<u>9,999</u>	<u>—</u>	<u>220,415</u>	<u>264,457</u>
Total liabilities							<u>220,415</u>	<u>264,457</u>
Other segment information:								
Depreciation and amortisation	<u>9,177</u>	<u>5,943</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>9,177</u>	<u>5,943</u>
Impairment losses recognised in the profit and loss account	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>
Capital expenditure	<u>55,772</u>	<u>53,321</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>55,772</u>	<u>53,321</u>
Provision/(reversal of provision) against obsolete inventories	<u>(150)</u>	<u>20</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>(150)</u>	<u>20</u>
Provision for doubtful debts	<u>2,171</u>	<u>969</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>2,171</u>	<u>969</u>

31 December 2004

## 5. TURNOVER, OTHER REVENUE AND GAINS

Turnover represents the invoiced value of goods sold, and after allowances for goods returned and trade discounts. All significant intra-group transactions have been eliminated on consolidation.

Revenue from the following activities has been included in turnover: An analysis of turnover, other revenue and gains is as follows:

	Group	
	2004 RMB'000	2003 RMB'000
<b>Turnover</b>		
Sale of petroleum machineries	487,688	302,274
	<b>487,688</b>	<b>302,274</b>
<b>Other revenue</b>		
Subcontracting income	1,568	4,491
Investment income from a trust investment	289	—
Interest income	1,029	893
Government grants and subsidies	3,019	2,391
VAT refund	9,168	10,039
Rental income	98	98
Insurance claim/Compensation income	—	863
Others	185	562
	<b>15,356</b>	<b>19,337</b>
<b>Gains</b>		
Gain on disposal of subsidiaries	—	2,658
Gain on disposal of fixed assets	102	—
	<b>102</b>	<b>2,658</b>
	<b>15,458</b>	<b>21,995</b>

Notes:

- (i) Government grants and subsidies for the year ended 31 December 2004 represented export subsidy and bonus for being successfully listed on the Growth Enterprise Market (the "GEM") of The Stock Exchange of Hong Kong Limited (the "Stock Exchange"), which amounted to RMB1,219,000 and RMB1,800,000 respectively. Government grants and subsidies for the year ended 31 December 2003 mainly consisted of export subsidy, new product development subsidy and enterprise technology subsidy.
- (ii) The Company's subsidiary, namely, Shouguang Molong Machinery Company limited (壽光市墨龍機械有限公司) ("Molong Machinery") was approved by the Ministry of Civil Affairs of Shandong Province (山東省民政廳) as a welfare enterprise (民政福利企業). According to the tax document Guo Shui Fa [1994] No.155, "Notice about the levy of turnover tax of welfare enterprises issued by the State Tax Bureau" ("國家稅務局關於民政福利企業徵收流轉稅問題的通知"), the output value added tax ("VAT") paid by Molong Machinery is refundable.

31 December 2004

## 6. PROFIT FROM OPERATING ACTIVITIES

The Group's profit from operating activities is arrived at after charging/(crediting):

	Notes	2004 RMB'000	2003 RMB'000
Auditors' remuneration		600	1
Cost of inventories sold		391,030	226,872
Depreciation	14	9,169	5,943
Loss on disposal of subsidiaries		—	(2,658)
Amortisation of an intangible asset	15	8	—
Minimum lease payments under operating leases:			
Land and buildings located in the PRC		267	267
Provision/(reversal of provision) against obsolete inventory		(150)	20
Provision for doubtful debts		2,171	969
Preliminary expenses		8	779
Research and development costs: current year expenditure		3,983	4,232
Staff costs (including directors' remuneration (note 8)):			
Wages and salaries		16,675	11,182
Retirement benefits cost		1,765	1,416
		<b>18,440</b>	<b>12,598</b>
Rental income		(98)	(98)
Interest income		(1,029)	(893)

## 7. FINANCE COSTS

	Group	2004 RMB'000	2003 RMB'000
Interest on bank borrowings wholly repayable within five years		4,572	4,738



31 December 2004

## 8. DIRECTORS' REMUNERATION

Directors' remuneration for the year, disclosed pursuant to rules 18.28 and 18.29 of the GEM Listing Rules and Section 161 of the Companies Ordinance, is as follows:

	Group	
	2004 RMB'000	2003 RMB'000
Fees	—	—
Other emoluments:		
Salaries, allowances and benefits in kind	243	171
Retirement benefits scheme contributions	6	6
Bonuses	540	41
	<u>789</u>	<u>218</u>

There was no arrangement under which a director waived or agreed to waive any remuneration during the year.

### (a) Independent non-executive directors

The fees paid to independent non-executive directors were as follows:

	2004 RMB'000	2003 RMB'000
Mr. Qin Xue Chang (秦學昌)	30	30
Mr. Yan Yi Zhuang (閻翊莊)	64	48
Mr. Loke Yu alias Loke Hoi Lam (陸海林)	50	—
	<u>144</u>	<u>78</u>

There were no other emoluments payable to the independent non-executive directors during the year (2003: Nil).

31 December 2004

## 8. DIRECTORS' REMUNERATION (continued)

## (b) Executive directors and non-executive directors

	Salaries, allowances and benefits in kind RMB'000	Performance related bonuses RMB'000	Pension scheme contributions RMB'000	Total emoluments RMB'000
2004				
Executive directors:				
Mr. Zhang En Rong (張恩榮)	28	189	—	217
Mr. Zhang Yun San (張雲三)	25	122	2	149
Mr. Lin Fu Long (林福龍)	20	137	2	159
Mr. Xie Xin Cang (謝新倉)	26	92	2	120
	<u>99</u>	<u>540</u>	<u>6</u>	<u>645</u>
Non-executive directors:				
Mr. Chen Jian Xiong (陳建雄)	—	—	—	—
Mr. Wang Ping (王平)	—	—	—	—
	<u>99</u>	<u>540</u>	<u>6</u>	<u>645</u>
	Salaries, allowances and benefits in kind RMB'000	Performance related bonuses RMB'000	Pension scheme contributions RMB'000	Total emoluments RMB'000
2003				
Executive directors:				
Mr. Zhang En Rong (張恩榮)	25	41	—	66
Mr. Zhang Yun San (張雲三)	22	—	2	24
Mr. Lin Fu Long (林福龍)	23	—	2	25
Mr. Xie Xin Cang (謝新倉)	23	—	2	25
	<u>93</u>	<u>41</u>	<u>6</u>	<u>140</u>
Non-executive directors:				
Mr. Chen Jian Xiong (陳建雄)	—	—	—	—
Mr. Wang Ping (王平)	—	—	—	—
	<u>93</u>	<u>41</u>	<u>6</u>	<u>140</u>

31 December 2004

## 9. FIVE HIGHEST PAID EMPLOYEES

The five highest paid employees during the year included four (2003: Nil) directors, details of whose remuneration are set out in note 8 above. Details of the remuneration of the remaining one (2003: five) non-director(s), highest paid employee(s) for the year are as follows:

	Group	
	2004 RMB'000	2003 RMB'000
Salaries and allowances	20	274
Retirement benefits scheme contributions	2	6
Bonuses	98	—
	<b>120</b>	<b>280</b>

The number of the non-director, highest paid employees whose remuneration fell within the following band is as follows:

	2004	2003
Nil to HK\$1,000,000	<b>1</b>	<b>5</b>

## 10. TAX

The Company is located in the PRC and as a result is subject to the PRC corporate income tax at a rate of 33% on its assessable profits. No provision for Hong Kong profits tax has been made as the Group did not generate any assessable profits in Hong Kong during the year.

The Company's subsidiaries, namely, Molong Machinery and Weifang Molong Drilling Equipment Company Limited (濰坊墨龍鑽探設備有限公司) ("Molong Drilling Equipment") were approved by the Ministry of Civil Affairs of Shandong Province (山東省民政廳) as welfare enterprises (民政福利企業) and hence were entitled to a full exemption from corporate income tax for years 2003 and 2004 respectively according to the tax document Cai Shui Zi [1994] No.1 ("關於企業所得稅若干優惠政策的通知").

	Group	
	2004 RMB'000	2003 RMB'000
Total current – PRC tax charge for the year	12,818	13,197
Tax exemption granted for prior year	(11,333)	—
	<b>1,485</b>	<b>13,197</b>

31 December 2004

**10. TAX (continued)**

A reconciliation of the tax expense applicable to profit before tax using the statutory rates for the PRC in which the Company and its subsidiaries is domiciled to the tax expense at the effective tax rates, and a reconciliation of the applicable rates (i.e., the statutory tax rates) to the effective tax rates, is as follows:

	<b>2004</b> <b>RMB'000</b>	2003 RMB'000
Profit before tax	<b>65,576</b>	59,347
Tax at the statutory tax rate	<b>21,640</b>	19,585
Income not subject to tax	<b>(539)</b>	—
Expenses not deductible for tax	<b>37</b>	849
Tax exemption granted to welfare enterprises for prior year	<b>(11,333)</b>	—
Tax exemption granted to welfare enterprises for current year	<b>(1,617)</b>	—
Adjustments in respect of current tax of previous period	<b>(680)</b>	—
Tax exemption of purchased fixed assets used for qualified technological improvement projects	<b>(6,023)</b>	(6,360)
Gain on disposal of subsidiaries not taxable for income tax purposes	—	(877)
Actual income tax	<b>1,485</b>	13,197
At the effective tax rate	<b>2%</b>	22%

**11. NET PROFIT FROM ORDINARY ACTIVITIES ATTRIBUTABLE TO SHAREHOLDERS**

The net profit from ordinary activities attributable to shareholders for the year ended 31 December 2004 dealt with in the financial statements of the Company, was RMB114,706,000 (2003: RMB17,131,000) (note 26(b)).

**12. DIVIDENDS**

	<b>2004</b> <b>RMB'000</b>	2003 RMB'000
Interim – RMB0.02 (2003: Nil) per ordinary share	<b>10,806</b>	—
Proposed final – RMB0.015 (2003: Nil) per ordinary share	<b>8,100</b>	—
	<b>18,906</b>	—

The proposed final dividend for the year is subject to the approval of the Company's shareholders at the forthcoming annual general meeting.

31 December 2004

### 13. EARNINGS PER SHARE

The calculation of basic earnings per share is based on the net profit attributable to shareholders for the year of RMB61,366,000 (2003: RMB43,977,000), and the weighted average of 501,261,934 (2003: 405,000,000) ordinary shares in issue during the year, as adjusted to reflect the rights issue during the year.

No diluted earnings per share amounts have been presented for the year as no diluting events existed during the year.

### 14. FIXED ASSETS

Group

	Leasehold land and buildings	Plant and machinery	Electronic equipment	Motor vehicles	Other equipment	Construction in progress	Total
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
Cost:							
At beginning of year	37,659	59,513	1,554	5,434	1,978	755	106,893
Additions	2,219	12,514	237	1,008	244	39,550	55,772
Transfers	—	1,891	—	—	—	(1,891)	—
Disposals	—	(231)	—	(381)	—	—	(612)
At 31 December 2004	39,878	73,687	1,791	6,061	2,222	38,414	162,053
Accumulated depreciation:							
At beginning of year	4,308	12,598	359	2,008	577	—	19,850
Provided during the year	1,556	6,073	304	973	263	—	9,169
Disposals	—	(112)	—	(312)	—	—	(424)
At 31 December 2004	5,864	18,559	663	2,669	840	—	28,595
Net book value:							
At 31 December 2004	34,014	55,128	1,128	3,392	1,382	38,414	133,458
At 31 December 2003	33,351	46,915	1,195	3,426	1,401	755	87,043

The Group leases its leasehold building situated in Shouguang, the PRC with an estimated useful life of 20 years and a net book value amounting to RMB1,710,000 (31 December 2003: RMB1,795,000) under an operating lease arrangement.

At 31 December 2004, certain of the Group's machinery with a net book value of RMB13,155,000 (2003: RMB27,980,000) were pledged to secure the Group's bank loans (note 24).

The Group's land and buildings included above are all situated in Shouguang, the PRC and are held under medium lease terms.

31 December 2004

## 14. FIXED ASSETS (continued)

Company

	<b>Leasehold land and buildings</b>	<b>Plant and machinery</b>	<b>Electronic equipment</b>	<b>Motor vehicles</b>	<b>Other equipment</b>	<b>Construction in progress</b>	<b>Total</b>
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
Cost:							
At beginning of year	37,441	34,647	1,383	3,764	1,927	755	79,917
Additions	2,076	11,176	191	879	240	39,550	54,112
Transfers from a subsidiary	347	16,100	217	1,739	55	—	18,458
Transferred from construction in progress	—	1,891	—	—	—	(1,891)	—
Disposals	—	(231)	—	(321)	—	—	(552)
At 31 December 2004	<u>39,864</u>	<u>63,583</u>	<u>1,791</u>	<u>6,061</u>	<u>2,222</u>	<u>38,414</u>	<u>151,935</u>
Accumulated depreciation:							
At beginning of year	4,162	3,886	275	1,187	482	—	9,992
Provided during the year	1,542	3,902	279	773	324	—	6,820
Transferred from a subsidiary	158	7,443	108	1,021	34	—	8,764
Disposals written back	—	(112)	—	(312)	—	—	(424)
At 31 December 2004	<u>5,862</u>	<u>15,119</u>	<u>662</u>	<u>2,669</u>	<u>840</u>	<u>—</u>	<u>25,152</u>
Net book value:							
At 31 December 2004	<u>34,002</u>	<u>48,464</u>	<u>1,129</u>	<u>3,392</u>	<u>1,382</u>	<u>38,414</u>	<u>126,783</u>
At 31 December 2003	<u>33,279</u>	<u>30,761</u>	<u>1,108</u>	<u>2,577</u>	<u>1,445</u>	<u>755</u>	<u>69,925</u>

The Company leases its leasehold building situated in Shouguang, the PRC with an estimated useful life of 20 years and a net book value amounting to RMB1,710,000 (31 December 2003: RMB1,795,000) under an operating lease arrangement.

The Company's land and buildings included above are all situated in Shouguang, the PRC and are held under medium lease terms.

31 December 2004

## 15. INTANGIBLE ASSET

	Group	Company
	Know-how RMB'000	Know-how RMB'000
Cost:		
Additions/At 31 December 2004	120	120
Accumulated amortisation:		
Provided during the year/At 31 December 2004	8	8
Net book value:		
At 31 December 2004	<u>112</u>	<u>112</u>

## 16. INTERESTS IN SUBSIDIARIES

	Company	
	2004 RMB'000	2003 RMB'000
Unlisted shares, at estimated fair value	5,400	7,450
Due from subsidiaries	19,452	—
	<u>24,852</u>	<u>7,450</u>

The amounts due from subsidiaries included in the Company's non-current assets were unsecured, interest-free and had no fixed terms of repayment.

Particulars of the principal subsidiaries are as follows:

Name	Place of registration and operations	Nominal value of registered share capital	Percentage of equity directly attributable to the Company	Principal activities
Shouguang Molong Machinery Company Limited (a)	PRC	RMB8,000,000	93.125%	Manufacture and sale of petroleum extraction machinery
Weifang Molong Drilling Equipment Company Limited (b)	PRC	RMB6,000,000	90%	Manufacture and sale of petroleum extraction machinery

(a) According to the resolution of a shareholders' meeting passed on 24 November 2004, Molong Machinery was voluntarily liquidated on 6 December 2004. The remaining assets and liabilities of Molong Machinery were distributed to its shareholders, i.e., the Company and Shouguang Maolong Machinery Company Limited ("Maolong Machinery") (壽光懋隆機械電氣有限公司), in proportion to their respective percentages of interests held in Molong Machinery. As such, an amount of RMB2,477,000 was distributed to Maolong Machinery by cash, and the remaining assets and liabilities were taken over by the Company.

(b) Molong Drilling Equipment is a welfare enterprise established on 29 September 2004.

31 December 2004

## 17. LONG TERM INVESTMENTS

	Group		Company	
	2004 RMB'000	2003 RMB'000	2004 RMB'000	2003 RMB'000
Unlisted equity investment, at estimated fair value	50	50	50	50
Others	—	6,000	—	6,000
	<b>50</b>	<b>6,050</b>	<b>50</b>	<b>6,050</b>

The unlisted equity investment represented a 10% equity interest held in Shouguang Maolong Old Metals Recycle Company Limited (壽光市懋隆廢舊金屬回收有限公司), which was incorporated in the PRC on 13 December 2002 with a registered capital of RMB500,000.

## 18. INVENTORIES

	Group		Company	
	2004 RMB'000	2003 RMB'000	2004 RMB'000	2003 RMB'000
Raw materials	42,546	11,629	36,080	6,320
Work in progress	34,158	15,867	31,716	2,477
Finished goods	63,580	40,489	47,384	13,830
	<b>140,284</b>	<b>67,985</b>	<b>115,180</b>	<b>22,627</b>

None of the above balance was carried at net realisable value.



31 December 2004

## 19. TRADE RECEIVABLES

The Group's trading terms with its customers are mainly on credit, except for new customers, where payment in advance is normally required. The credit period is generally for a period of three months, extending up to six months for major customers. Each customer has a maximum credit limit. The Group seeks to maintain strict control over its outstanding receivables to minimise credit risk. Overdue balances are reviewed regularly by senior management.

An aged analysis of the trade receivables as at the balance sheet date, based on invoice date, and net of provisions, is as follows:

	Group		Company	
	2004 RMB'000	2003 RMB'000	2004 RMB'000	2003 RMB'000
Within 3 months	81,408	45,234	81,408	32,002
3 to 6 months	7,746	4,462	7,746	697
6 months to 1 year	717	3,578	717	131
1 to 2 years	—	2,045	—	310
	<b>89,871</b>	<b>55,319</b>	<b>89,871</b>	<b>33,140</b>

## 20. OTHER RECEIVABLES

	Group		Company	
	2004 RMB'000	2003 RMB'000	2004 RMB'000	2003 RMB'000
Prepayments	13,165	48,312	13,125	46,668
Deposits and other debtors	2,156	6,559	2,156	5,950
	<b>15,321</b>	<b>54,871</b>	<b>15,281</b>	<b>52,618</b>

31 December 2004

## 21. CASH AND CASH EQUIVALENTS AND PLEDGED DEPOSITS

Note	Group		Company	
	2004 RMB'000	2003 RMB'000	2004 RMB'000	2003 RMB'000
Cash and bank balances	26,077	63,087	25,837	42,981
Time deposits	61,886	34,072	61,886	34,072
	<b>87,963</b>	97,159	<b>87,723</b>	77,053
Less: Pledged time deposits:				
Pledged for bills payable	22 (61,886)	(34,072)	(61,886)	(34,072)
Cash and cash equivalents	<b>26,077</b>	63,087	<b>25,837</b>	42,981

At the balance sheet date, the cash and bank balances of the Group denominated in Renminbi ("RMB") amounted to RMB87,960,000 (2003: RMB95,504,000). The RMB is not freely convertible into other currencies, however, under the Mainland China's Foreign Exchange Control Regulations and Administration of Settlement, Sale and Payment of Foreign Exchange Regulations, the Group is permitted to exchange RMB for other currencies through banks authorised to conduct foreign exchange business.

## 22. TRADE AND BILLS PAYABLES

An aged analysis of the trade and bills payables as at the balance sheet date, based on invoice date, is as follows:

	Group		Company	
	2004 RMB'000	2003 RMB'000	2004 RMB'000	2003 RMB'000
Within 3 months	102,871	67,261	100,281	60,101
3 to 6 months	62,893	48,213	62,493	46,810
6 months to 1 year	1,690	3,872	1,631	2,123
1 to 2 years	1,642	975	1,615	343
	<b>169,096</b>	120,321	<b>166,020</b>	109,377

The Group and the Company's bills payables of RMB124,822,000 (2003: RMB64,702,000) were secured by the pledge of certain of the time deposits amounting to RMB61,886,000 (2003: RMB34,072,000) (note 21).

31 December 2004

## 23. OTHER PAYABLES AND ACCRUALS

	Group		Company	
	2004 RMB'000	2003 RMB'000	2004 RMB'000	2003 RMB'000
Advance from customers	10,573	28,180	10,570	1,513
Payroll payable	2,565	1,946	2,269	1,698
Welfare payable	2,458	2,158	2,417	1,850
Other payables	2,659	12,132	5,585	6,211
Accruals	1,951	2,840	1,404	1,624
	<b>20,206</b>	<b>47,256</b>	<b>22,245</b>	<b>12,896</b>

## 24. INTEREST-BEARING BANK LOANS

	Group		Company	
	2004 RMB'000	2003 RMB'000	2004 RMB'000	2003 RMB'000
Secured	15,000	55,000	15,000	55,000
Unsecured	15,000	35,000	15,000	35,000
	<b>30,000</b>	<b>90,000</b>	<b>30,000</b>	<b>90,000</b>
Bank loans repayable:				
Within one year	30,000	65,000	30,000	65,000
In the second year	—	25,000	—	25,000
	<b>30,000</b>	<b>90,000</b>	<b>30,000</b>	<b>90,000</b>

The Group's bank loans are secured by mortgages over the Group's machinery, which had an aggregate net book value at the balance sheet date of approximately RMB13,155,000 (2003: RMB27,980,000) (note 14).

31 December 2004

## 25. SHARE CAPITAL

Shares	<b>2004</b> <b>RMB'000</b>	2003 RMB'000
Authorised:		
539,998,000 (2003: 405,000,000) ordinary shares of RMB0.10 each	<u>54,000</u>	<u>40,500</u>
Issued and fully paid		
539,998,000 (2003: 405,000,000) ordinary shares of RMB0.10 each	<u>54,000</u>	<u>40,500</u>

During the year, the movements in share capital were as follows:

- (a) Pursuant to a special resolution passed on 20 March 2004 and the approval document issued by China Securities Regulatory Commission (the "CSRC") on 29 December 2003, the Company was authorised to offer the H shares for subscription and apply for the listing on GEM of 138,276,000 shares of RMB0.10 each, comprising 134,998,000 new H shares and 3,278,000 H Shares converted from 3,278,000 state-owned domestic shares.
- (b) On 15 April 2004, 138,276,000 ordinary shares of RMB0.10 each were issued to the public by way of public offering and placing of shares at a price of HK\$0.70 (equivalent to approximately RMB0.7425) per share for a total cash consideration, before the related issue expenses, of HK\$96,793,000 (equivalent to approximately RMB102,669,000).

A summary of the transactions during the year with reference to the above movements in the Company's issued ordinary share capital is as follows:

	Number of shares in issue	Issued share capital RMB'000	Share premium account RMB'000	Total RMB'000
At 1 January 2003	405,000,000	40,500	21,278	61,778
2003 movement	—	—	(651)	(651)
At 1 January 2004	405,000,000	40,500	20,627	61,127
Issue of new shares (b)	134,998,000	13,500	89,169	102,669
Share issue expenses	—	—	(21,760)	(21,760)
At 31 December 2004	<u>539,998,000</u>	<u>54,000</u>	<u>88,036</u>	<u>142,036</u>

31 December 2004

## 26. RESERVES

### (a) Group

The amounts of the Group's reserves and the movements therein for the current and prior years are presented in the consolidated statement of changes in equity on page 34 of the financial statements.

Pursuant to the relevant laws and regulations for business enterprises, a portion of the profits of the Group's entities which are incorporated in the PRC has been transferred to the statutory reserve fund and statutory welfare fund which are restricted as to use.

### (b) Company

	Notes	Capital reserve RMB'000	Statutory reserve fund RMB'000	Statutory welfare fund RMB'000	Retained profits RMB'000	Total RMB'000
Balance at 1 January 2003		18,568	1,352	675	(21,888)	(1,293)
Net profit for the year		—	—	—	17,131	17,131
Transfers		—	1,284	642	(1,926)	—
At 31 December 2003		18,568	2,636	1,317	(6,683)	15,838
Issue of shares	25	89,169	—	—	—	89,169
Share issue expenses	25	(21,760)	—	—	—	(21,760)
Net profit for the year		—	—	—	114,706	114,706
Interim 2004 dividend	12	—	—	—	(10,806)	(10,806)
Proposed final 2004 dividend	12	—	—	—	(8,100)	(8,100)
Transfers		—	6,136	3,068	(9,204)	—
At 31 December 2004		85,977	8,772	4,385	79,913	179,047

Included in the net profit for the year is investment income of RMB88,024,000, comprising interim dividend of RMB61,751,000 attributed by Molong Machinery and cumulative gain of RMB26,273,000 derived from the liquidation of Molong Machinery (note 16 (a)).

For the details of the statutory funds, please refer to the consolidated statement of changes in equity on page 34 of the financial statements.

## 27. CONTINGENT LIABILITIES

At the balance sheet date, neither the Group, nor the Company had any significant contingent liabilities.

As at 31 December 2003, the Company had provided counter-guarantee to Shandong International Trust and Investment Corporation ("SDITIC") in relation to the guarantee granted by SDITIC to the Company for bills payable of RMB6,000,000. The counter-guarantee provided by the Company to SDITIC was by way of pledging the Company's beneficiary interests under a fund management trust agreement entered into between the Company and SDITIC.

31 December 2004

## 28. PLEDGE OF ASSETS

Details of the Group's bank loans, which are secured by the assets of the Group, are included in note 24 to the financial statements.

## 29. OPERATING LEASE ARRANGEMENTS

### (a) As lessor

The Group leases its leasehold buildings (note 14 to the financial statements) under operating lease arrangements, with leases negotiated for terms ranging from 2 to 6 years. The terms of the leases generally also require the tenants to pay security deposits and provide for periodic rent adjustments according to the then prevailing market conditions.

At 31 December 2004, the Group had total future minimum lease receivables under non-cancellable operating leases with its tenants falling due as follows:

	Group	
	2004 RMB'000	2003 RMB'000
Within one year	98	143
In the second to fifth years, inclusive	392	626
After five years	196	512
	<b>686</b>	<b>1,281</b>

### (b) As lessee

The Group leases certain of its factories and staff dormitories under operating lease arrangements. Leases for properties are negotiated for terms of 10 years.

At 31 December 2004, the Group and the Company had total future minimum lease payments under non-cancellable operating leases falling due as follows:

	Group		Company	
	2004 RMB'000	2003 RMB'000	2004 RMB'000	2003 RMB'000
Within one year	267	267	267	267
In the second to fifth years, inclusive	1,068	800	1,068	800
After five years	532	1,066	532	1,066
	<b>1,867</b>	<b>2,133</b>	<b>1,867</b>	<b>2,133</b>

31 December 2004

### 30. COMMITMENTS

In addition to the operating lease commitments detailed in note 29(b) above, the Group and the Company had the following commitments at the balance sheet date:

#### (a) Capital commitments

	Group		Company	
	2004 RMB'000	2003 RMB'000	2004 RMB'000	2003 RMB'000
Contracted, but not provided for:				
Land and buildings	37,144	—	37,144	—
Plant and machinery	90,640	1,923	90,640	1,923
Intangible assets	186	—	186	—
	<b>127,970</b>	1,923	<b>127,970</b>	1,923
Authorised, but not contracted for:				
Plant and machinery	43,750	—	43,750	—
	<b>171,720</b>	1,923	<b>171,720</b>	1,923

### 31. RELATED PARTY TRANSACTIONS

In addition to the transactions and balances detailed elsewhere in these financial statements, the Group had the following material transactions with related parties during the year:

#### Group

	Notes	2004 RMB'000	2003 RMB'000
Purchases of raw materials from a company in which a director of the Company is a shareholder	(i)	283	310
Purchases of raw materials from other related parties	(i)	30,820	18,629
Sales of raw materials to a company in which a director of the Company is a shareholder	(ii)	244	1,389
Sales of raw materials to other related parties	(ii)	656	2,822
Sales of goods to an associate	(ii)	—	8,552
Subcontracting income from a company in which a director of the Company is a shareholder	(vii)	79	595
Subcontracting income from other related parties	(vii)	295	—
Rental income from a company in which a director of the Company is a shareholder	(iii)	98	98

31 December 2004

## 31. RELATED PARTY TRANSACTIONS (continued)

Group

	Notes	2004 RMB'000	2003 RMB'000
Rental expenses paid to a company in which a director of the Company is a shareholder	(iii)	267	267
Fixed assets transferred to a company in which a director of the Company is a shareholder	(iv)	—	15
Fixed assets transferred to other related party	(v)	—	14
Fixed assets transferred from a company in which a director of the Company is a shareholder	(vi)	—	4
Subcontracting fee paid to a company in which a director of the Company is a shareholder	(vii)	422	71
Subcontracting fee paid to other related parties	(vii)	146	94
Purchase of leasehold land from other related party	(viii)	—	125
Disposal of leasehold land to a company in which a director of the Company is a shareholder	(ix)	—	125
Disposal of leasehold land to other related party	(ix)	—	1,008
Disposal of a subsidiary to a director	(x)	—	39,000
Disposal of a subsidiary to other related party	(xi)	—	8,194
Purchase of raw materials from other related party	(xii)	—	114
Dividend to a minority shareholder in which a director of the Company is a shareholder		4,559	—

Notes:

- (i) The directors consider that the purchases of raw materials were made according to the published prices and conditions similar to those offered to the major customers of the suppliers. The balance owing to the suppliers as at 31 December 2004 was RMB811,000 (2003: Nil), which was unsecured, interest-free and had no fixed terms of repayment.
- (ii) The sales to the related parties were made according to the published prices and conditions offered to the customers of the Group. The amounts due from the related parties was nil as at 31 December 2004. The amounts due from related parties of RMB10,429,000 at 31 December 2003 were unsecured, interest-free and had no fixed terms of repayment.
- (iii) These transactions were determined at rates mutually agreed between the related parties, which were lower than the market rates for properties of similar locations.
- (iv) The fixed assets transferred to the related party included office buildings and machineries, which were transferred at their net book value amounts.



31 December 2004

## 31. RELATED PARTY TRANSACTIONS (*continued*)

Notes: (*continued*)

- (v) The fixed assets transferred to the other related party included plant and machinery, which were transferred at their net book value amounts.
- (vi) The fixed assets transferred from the related party included plant and machinery, which were transferred at their net book value amounts.
- (vii) These transactions were conducted on the basis of rates mutually agreed between the related parties, which were set at cost incurred plus a margin of 5%.
- (viii) On 28 January 2003, the Company purchased certain leasehold land from the other related party at its net book value amount. The leasehold land was subsequently disposed of at its net book value amount to a company in which a director of the Company is a shareholder. Refer to note (ix) below.
- (ix) On 30 April 2003, the Company disposed of certain leasehold land to its related parties at their net book value amounts.
- (x) The subsidiary was disposed of at a consideration calculated on the basis of the original investment cost in the subsidiary.
- (xi) The subsidiary was disposed of at a consideration calculated on the basis of the unaudited net asset value of the subsidiary at 26 January 2003, which resulted in a gain on disposal amounting to RMB473,343.
- (xii) The purchase transactions were made at cost.

The related party transaction in respect of item (i), (ii), (iii) and (vii) also constitute connected transactions or continuing connected transactions as defined in chapter 20 of the GEM listing rules.

## 32. POST BALANCE SHEET EVENT

Pursuant to a special resolution (“Special Resolution”) passed in the extraordinary general meeting (the “EGM”) and the two separate class meetings held on 14 February 2005 respectively, a specific mandate (“Specific Mandate”) has been granted to the Board to issue not less than 54,000,000 and not more than 108,000,000 new H shares. The Directors intend to use the net proceeds from the issue of such new H Shares to purchase a full set of new machinery and equipment for producing of casing (石油套管) and the related accessories.

The Company has made an application for the issue of the new H Shares to the CSRC and is still awaiting approval as at the date of the financial statements. Pursuant to the Special Resolution, the Board will only exercise its power under the Special Mandate only if the necessary approvals from the CSRC and/or other relevant PRC government authorities have been obtained.

## 33. APPROVAL OF THE FINANCIAL STATEMENTS

The financial statements were approved and authorised for issue by the board of directors of the Company on 16 March 2005.

**NOTICE IS HEREBY GIVEN THAT** the Annual General Meeting (“AGM”) of Shandong Molong Petroleum Machinery Company Limited (the “Company”, and together with its subsidiary, the “Group”) will be held at 9th Floor, No. 99 Beihai Road, Shouguang City, Shandong Province, The People’s Republic of China on Saturday, 7 May 2005 at 10:00 a.m. for the following purposes:

## ORDINARY RESOLUTIONS

1. To receive and consider the report of the directors of the Company for the year ended 31 December 2004;
2. To receive and consider the report of the supervisors of the Company for the year ended 31 December 2004;
3. To receive and consider the audited consolidated financial statements and the report of the auditors for the year ended 31 December 2004;
4. To consider and approve the declaration by the Board of a final dividend of RMB0.015 inclusive of tax per share for the year ended 31 December 2004, payable to shareholders whose name appear on the register of shareholders of the Company at the close of business on 13 April 2005, and to authorise the Directors to take any necessary actions required under the applicable laws and regulations in connection thereto;
5. To re-elect Chen Jian Xiong as a Director and to authorise the board of Directors (the “Board”) to determine his remuneration;
6. To consider and approve the re-appointment of Ernst & Young and Ernst & Young Huaming as the International and PRC auditors of the Company respectively for the year ending 31 December 2005 and to authorise the Board to fix their remuneration; and
7. To consider and approve any motion proposed by any shareholders holding 5.0% of the shares of the Company with voting rights at the meeting, if any.

## SPECIAL RESOLUTION

8. To consider and, if thought fit, pass the following resolution as a Special Resolution:

### THAT:

- (1) there be granted to the Board an unconditional general mandate (“General Mandate”) to issue, allot and deal with additional shares in the capital of the Company (whether Domestic Shares or H Shares) and to make or grant offers or agreements in respect thereof, subject to the following conditions:
  - (a) such mandate shall not extend beyond the Relevant Period save that the Board may during the Relevant Period make or grant offers or agreements which might require the exercise of such powers after the end of the Relevant Period;

- (b) the aggregate nominal amount of shares allotted or agreed conditionally or unconditionally to be allotted (whether pursuant to an option or otherwise) by the Board otherwise than pursuant to any scrip dividends or similar arrangement providing for the allotment of such shares in lieu of the whole or part of a dividend on such shares or any share option scheme adopted by the Company and in accordance with the articles of association of the Company (“Articles of Association”), shall not exceed:
  - i. 20 per cent of the aggregate amount of domestic shares of the Company in issue; and
  - ii. 20 per cent of the aggregate nominal amount of H shares of the Company in issue,in each case as at the date of passing of this resolution; and
- (c) the Board will only exercise its power under such mandate in accordance with the Company Law of the PRC and the Rules Governing the Listing of Securities on the Growth Enterprise Market of The Stock Exchange of Hong Kong Limited (as the same may be amended from time to time) and only if all necessary approvals from the China Securities Regulatory Commission and/or other relevant PRC government authorities are obtained;

For the purposes of this resolution:

“Domestic Share(s)” mean the ordinary domestic share(s) with a nominal value of RMB0.10 each in the registered share capital of the Company which were subscribed for in RMB;

“H Shares” mean the overseas listed foreign invested shares with a nominal value of RMB0.10 each in the registered share capital of the Company, which are listed on the Growth Enterprise Market of The Stock Exchange of Hong Kong Limited and subscribed for and traded in Hong Kong dollars;

“Relevant Period ” means the period from the date of passing this resolution until the earliest of:

- (a) the conclusion of the next annual general meeting of the Company following the passing of this resolution; or
- (b) the expiry date of the 12-month period following the passing of this resolution; or
- (c) the passing of a special resolution of the Company in a general meeting revoking or varying the authority set out in this resolution.

- (2) contingent on the Board resolving to issue shares pursuant to paragraph (1) of this resolution, the Board be authorised:
- (a) to approve, execute and do, or procure to be executed and done all such documents, deeds and matters which it may consider necessary in connection with the issue of such new shares, including but not limited to the time, quantity and place for such issue, to make all necessary applications to the relevant authorities, and to enter into underwriting agreement(s) or any other agreement(s);
  - (b) to determine the use of proceeds and to make necessary filings and registration with the relevant authorities in the PRC, and/or Hong Kong and any other places and jurisdictions (as appropriate);
  - (c) to increase the registered capital of the Company and make any amendments to the Articles of Association in accordance with such increase and to register the increased capital with the relevant authorities in the PRC and/or Hong Kong and any other places and jurisdictions (as appropriate) so as to reflect the new capital and/or share capital structure of the Company resulting from the intended allotment and issue of the shares of the Company pursuant to paragraph (1) of this resolution.

By order of the Board

**Shandong Molong Petroleum Machinery Company Limited**

**Zhang En Rong**

Chairman

Shandong, the PRC,

16 March 2005

Notes:

- (A) The register of shareholders of the Company will be closed from 7 April 2005 to 6 May 2005 (both days inclusive) during which no transfer of the Company's shares will be effected. Any holder of the shares of the Company whose name appears on the Company's register of shareholders of the Company at the close of business on 6 April 2005 and have completed the registration process will be entitled to attend and vote at the AGM.
- (B) Shareholders who intend to attend the AGM should complete and return the reply slip and return it to the Company's H Shares registrar in Hong Kong at Tricor Investor Services Limited, Ground Floor, Bank of East Asia Harbour View Centre, 56 Gloucester Road, Wanchai, Hong Kong (for H Shares) or to the registered office of the Company at No. 99, Beihai Road, Shouguang City, Shandong Province, The People's Republic of China (for Domestic Shares) on or before 17 April 2005.



- (C) Any Shareholder entitled to attend and vote at the AGM are entitled to appoint in writing one or more persons as his proxy to attend and vote on his behalf. A proxy need not be a member of the Company. For shareholders appointing more than one proxy, the instrument(s) appointing each of proxies shall specify the class of number of shares represented by such proxies.
- (D) In order to be valid, the instrument appointing a proxy shall be in writing under the hand of the appointer or his attorney duly authorised in writing or, if the appointer is a legal person, it shall be under seal or under the hand of a Director or attorney duly authorised.
- (E) The instrument appointing a proxy shall be deposited to the Company's H Share registrar in Hong Kong (for H Shares), Tricor Investor Services Limited or the Company's registered office (for Domestic Shares) at the addresses as listed in Note (B) above not less than 24 hours before the time of holding of the AGM.
- (F) Shareholders attending the AGM shall be responsible for their own transportation and accommodation expenses.

