



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)

2005

INTERIM REPORT

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This report, for which the directors of Shandong Molong Petroleum 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 for the purpose of giving information with regard to 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.

HIGHLIGHTS

- Achieved turnover of approximately RMB323,866,000 for the six months ended 30 June 2005, which represents a growth of approximately RMB108,160,000 as compared to that of the same period last year.
- The net profit increased by approximately 45.9% to approximately RMB36,556,000 as compared to that of the same period last year.
- Earnings per share of the Group was approximately RMB6.4 cents for the six months ended 30 June 2005.
- The Directors have resolved to pay an interim dividend of RMB2 cents per share for the six months ended 30 June 2005, subject to the approval of the shareholders of the Company.

The board (the "**Board**") of directors (the "**Directors**") of the Company is pleased to announce the unaudited results of Shandong Molong Petroleum Machinery Company Limited (the "**Company**") and its subsidiary (collectively, the "**Group**") for the six months ended 30 June 2005.

INTERIM DIVIDEND

Subject to the approval of the shareholders of the Company at an extraordinary general meeting ("**EGM**") to be convened by the Company on 3 October 2005, the Board proposes to declare and pay an interim dividend of RMB2 cents per share in respect of the six months ended 30 June 2005 to the shareholders of the Company whose names appear on the register of members of the Company on 2 October 2005. The register of members of the Company will be closed from 3 September 2005 to 2 October 2005, both days inclusive, during which period no share transfer shall be effected. In order to qualify for the interim dividend and attending the above extraordinary general meeting, all instruments of transfer accompanied by the relevant share certificates must be lodged with the Company's H share registrar, Tricor Investor Services Limited, at G/F., Bank of East Asia Harbour View Centre, 56 Gloucester Road, Wanchai, Hong Kong for registration no later than 4:00 p.m. on 2 September 2005.

UNAUDITED CONDENSED CONSOLIDATED PROFIT AND LOSS ACCOUNT

For the three months and six months ended 30 June 2005

The unaudited results of the Group for the three months and six months ended 30 June 2005 together with the unaudited comparative figures for the corresponding periods in 2004 are as follows:

	Notes	Three months ended 30 June		Six months ended 30 June	
		2005 RMB'000	2004 RMB'000	2005 RMB'000	2004 RMB'000
Turnover	(2)	165,866	131,180	323,866	215,706
Cost of sales		(128,653)	(103,876)	(255,378)	(167,978)
Gross profit		37,213	27,304	68,488	47,728
Other revenue and gains	(3)	939	2,331	3,908	8,629
Selling and distribution costs		(5,273)	(4,472)	(9,340)	(6,731)
Administrative expenses		(5,495)	(2,310)	(10,267)	(5,486)
Other operating expenses		(129)	(1,648)	(1,613)	(2,728)
Profit from operating activities	(4)	27,255	21,205	51,576	41,412
Finance costs		(654)	(1,249)	(1,677)	(2,573)
Profit before taxation		26,601	19,956	49,499	38,839
Taxation	(5)	(6,120)	(6,277)	(11,682)	(12,690)
Profit for the period		20,481	13,679	37,817	26,149
Attributable to:					
— Shareholders of the Company		19,852	13,288	36,556	25,060
— Minority interest		629	391	1,261	1,089
		20,481	13,679	37,817	26,149
Proposed dividends per share (RMB cents)		N/A	N/A	2.0	2.0
Earnings per share — basic (RMB cents)	(6)	3.5	2.9	6.4	5.4

CONDENSED CONSOLIDATED BALANCE SHEET

As at 30 June 2005 and 31 December 2004

	Notes	As at 30 June 2005 (unaudited) RMB'000	As at 31 December 2004 (audited) RMB'000 (Restated)
NON-CURRENT ASSETS			
Fixed assets		202,432	124,330
Intangible assets		295	112
Long term investment		50	50
Lease premium for land		8,744	8,872
		<u>211,521</u>	<u>133,364</u>
CURRENT ASSETS			
Inventories	(7)	186,333	140,284
Trade receivables	(8)	71,226	89,871
Note receivables		8,500	—
Prepayment, deposits and other receivables		52,063	15,321
Due from related parties		148	—
Lease premium for land		256	256
Pledged deposits		85,411	61,886
Cash and bank balances		72,137	26,077
		<u>476,074</u>	<u>333,695</u>
CURRENT LIABILITIES			
Trade and bill payables	(9)	252,393	169,096
Other payables and accruals		38,317	20,206
Tax payable		9,788	302
Interest bearing loans and borrowings		10,000	30,000
Due to related parties		260	811
		<u>310,758</u>	<u>220,415</u>
NET CURRENT ASSETS		<u>165,316</u>	<u>113,024</u>
TOTAL ASSETS LESS CURRENT LIABILITIES		<u>376,837</u>	<u>246,644</u>
MINORITY INTERESTS		<u>2,351</u>	<u>1,090</u>
NET ASSETS		<u>374,486</u>	<u>245,554</u>
CAPITAL AND RESERVES			
Issued capital		64,800	54,000
Reserves		296,726	183,454
Proposed dividend		12,960	8,100
		<u>374,486</u>	<u>245,554</u>

UNAUDITED CONDENSED CONSOLIDATED CASH FLOW STATEMENT

For the six months ended 30 June 2005 and 30 June 2004

	Six months ended 30 June	
	2005	2004
	RMB'000	RMB'000
Net cash inflow/(outflow) from operating activities	74,956	(53,697)
Net cash outflow from investment activities	(97,642)	(6,728)
Net cash inflow from financing activities	77,314	71,891
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Net increase in cash and cash equivalents	54,628	11,466
Cash and cash equivalents at the beginning of the period	57,528	97,159
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Cash and cash equivalents at the end of the period	112,156	108,625
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Analysis of balances of cash and cash equivalents		
Cash and bank balances	72,137	108,625
Time deposits with original maturity of less than three months when acquired, pledged as security for bills payable	40,019	—
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	112,156	108,625
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UNAUDITED CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

For the six months ended 30 June 2005 and 30 June 2004

	Paid-in capital	Capital reserve	Statutory reserve fund	Statutory welfare & other fund	Retained earnings	Subtotal of reserves	Proposed interim/ final dividend	Total
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
Balance at 1 January 2004	40,500	20,627	7,583	4,370	41,005	73,585	—	114,085
Net profit for the period	—	—	—	—	25,060	25,060	—	25,060
New issue of H shares upon public listing	13,500	—	—	—	—	—	—	13,500
Increase in share premium	—	86,640	—	—	—	86,640	—	86,640
Share issuing costs	—	(19,289)	—	—	—	(19,289)	—	(19,289)
Balance at 30 June 2004	<u>54,000</u>	<u>87,978</u>	<u>7,583</u>	<u>4,370</u>	<u>66,065</u>	<u>165,996</u>	<u>—</u>	<u>219,996</u>
Balance at 1 January 2005	54,000	88,036	16,039	8,019	71,360	183,454	8,100	245,554
Net profit for the period	—	—	—	—	36,556	36,556	—	36,556
Placing of new H shares	10,800	—	—	—	—	—	—	10,800
Increase in share premium	—	94,831	—	—	—	94,831	—	94,831
Share issuing costs	—	(5,155)	—	—	—	(5,155)	—	(5,155)
Dividend paid	—	—	—	—	—	—	(8,100)	(8,100)
Proposed dividend for the period	—	—	—	—	(12,960)	(12,960)	12,960	—
Balance at 30 June 2005	<u>64,800</u>	<u>177,712</u>	<u>16,039</u>	<u>8,019</u>	<u>94,956</u>	<u>296,726</u>	<u>12,960</u>	<u>374,486</u>

NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Amounts expressed in Renminbi unless otherwise stated)

1. BASIS OF PRESENTATION

The interim financial statements were unaudited. The interim financial statements have been reviewed by the audit committee of the Company.

The Company was incorporated as a joint stock company with limited liability in the People's Republic of China (the "PRC") on 30 December 2001 and its H shares were listed on the GEM (the "Listing") on 15 April 2004. On July 2004, the Company became a Sino-foreign joint stock limited company.

The unaudited financial statements of the Group have been prepared in accordance with Hong Kong Accounting Standard ("HKAS") 34 "Interim Financial Reporting" issued by the Hong Kong Institute of Certified Public Accountants and the disclosure requirements of the GEM Listing Rules.

The principal accounting policies used in the preparation of the unaudited financial statements are consistent with those used in the preparation of the Company's annual financial statements for the year ended 31 December, 2004, except that the Company has changed certain of its accounting policies following its adoption of new/revised Hong Kong Financial Reporting Standards and Hong Kong Accounting Standards ("new HKFRS") which are effective for accounting periods commencing on or after 1 January 2005.

The Directors considered that the adoption of the new HKFRS has had no material effect on how the results for the current or prior accounting periods are prepared and presented, except HKAS 17 "Leases" as explained below.

The adoption of revised HKAS 17 has resulted in a change of accounting policy relating to the reclassification of lease premium for land from fixed assets to operating leases. The up-front prepayments made for the lease premium for land are expensed in the profit and loss account on a straight line basis over the period of the lease or when there is impairment, the impairment loss is expensed in the profit and loss account. In prior years, the lease premium for land was accounted for at cost less accumulated depreciation and accumulated impairment losses and included in properties of fixed assets. HKAS 17 has been applied retrospectively.

Effects of adopting HKAS 17 on the condensed consolidated profit and loss account are as follows:

	Six months ended 30 June	
	2005	2004
	RMB'000	RMB'000
Increase/(decrease) in profit	Nil	Nil
Increase/(decrease) in earnings per share — basic	Nil	Nil

Effects of adopting HKAS 17 on the condensed balance sheet are as follows:

	As at 30 June 2005 (unaudited) RMB'000	As at 31 December 2005 (audited) RMB'000
Increase/(decrease) in assets		
Fixed assets	(9,000)	(9,128)
Lease premium for land (non-current and current)	9,000	9,128

2. TURNOVER & SEGMENT INFORMATION

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.

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. Save as disclosed below, no further business segment information is presented as over 90% of the Group's revenue and assets relate to the sales of petroleum machinery.

	For the six months ended 30 June 2005			
	PRC RMB'000	United States RMB'000	Other Countries RMB'000	Consolidated RMB'000
TURNOVER				
External sales	222,262	43,038	58,566	323,866
Other revenue	97	—	—	97
Total	222,359	43,038	58,566	323,963
Segment results	37,749	9,247	12,165	59,161
Unallocated income				3,811
Unallocated expenses				(11,796)
Profit from operating activities				51,176
Finance costs				(1,677)
Profit before taxation				49,499
Taxation				(11,682)
Profit before minority interests				37,817
Minority interests				(1,261)
Net profit from ordinary activities attributable to shareholders				36,556

For the six months ended 30 June 2004

	PRC RMB'000	United States RMB'000	Other Countries RMB'000	Consolidated RMB'000
TURNOVER				
External sales	175,218	32,242	8,246	215,706
Other revenue	192	—	—	192
Total	<u>175,410</u>	<u>32,242</u>	<u>8,246</u>	<u>215,898</u>
Segment results	<u>31,920</u>	<u>7,861</u>	<u>1,177</u>	40,958
Unallocated income				8,437
Unallocated expenses				<u>(7,983)</u>
Profit from operating activities				41,412
Finance costs				<u>(2,573)</u>
Profit before taxation				38,839
Taxation				<u>(12,690)</u>
Profit before minority interests				26,149
Minority interest				<u>(1,089)</u>
Net profit from ordinary activities attributable to shareholders				<u>25,060</u>

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3. **OTHER REVENUE AND GAINS**

	Three months ended		Six months ended	
	30 June		30 June	
	2005	2004	2005	2004
	RMB'000	RMB'000	RMB'000	RMB'000
Other revenue and gains				
Subcontracting income	97	192	97	192
Interest income	499	252	1,004	619
Government grant and subsidies	—	1,800	160	1,902
VAT refund	—	—	2,165	5,231
Rental income	—	—	98	587
Others	343	87	384	98
	<u>939</u>	<u>2,331</u>	<u>3,908</u>	<u>8,629</u>

4. PROFIT FROM OPERATING ACTIVITIES

The Group's profit from operating activities is arrived at after charging:

	Six months ended 30 June	
	2005	2004
	RMB'000	RMB'000
Cost of inventories sold	255,253	167,978
Depreciation of fixed assets	5,250	4,348
Provision for obsolete inventories	855	—
Provision for doubtful debts	(980)	1,406
Research and development costs	989	496
	<u> </u>	<u> </u>

5. TAXATION

	Three months ended		Six months ended	
	30 June		30 June	
	2005	2004	2005	2004
	RMB'000	RMB'000	RMB'000	RMB'000
The charge comprises				
PRC income tax	6,120	6,277	11,682	12,690
	<u> </u>	<u> </u>	<u> </u>	<u> </u>

The Company is located in the PRC and as a result is subject to PRC corporate income tax at a rate of 33% on their 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 review period.

The subsidiary of the Company, namely, Weifang Molong Drilling Equipment Company Limited ("Molong Drilling Equipment") was approved by the Ministry of Civil Affairs of Shandong Province as a welfare enterprise and hence is entitled to a full exemption from corporate income tax.

The group has no significant unprovided deferred tax as at 30 June 2004 and 2005.

6. EARNINGS PER SHARE

The calculation of the basic earnings per share is based on the profit attributable to shareholders of approximately RMB19,852,000 and RMB36,556,000 for the three months and six months ended 30 June 2005 (2004: RMB13,288,000 and RMB25,060,000) and on the weighted average number of approximately 569,832,000 (2004: 462,114,000) shares in issue during the period.

Diluted earnings per share is not presented for the three months and six months ended 30 June 2005 and 2004 as there were no potential dilutive securities in existence during the relevant periods.

7. **INVENTORIES**

	30 June 2005 (unaudited) RMB'000	31 December 2004 (audited) RMB'000
Raw materials	49,055	42,546
Work in progress	40,639	34,158
Finished goods	96,639	63,580
	<u>186,333</u>	<u>140,284</u>
Total	<u>186,333</u>	<u>140,284</u>

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

8. **TRADE RECEIVABLES**

An aged analysis of the trade receivables as at 31 December 2004 and 30 June 2005, based on invoice date, and net of provisions, is as follows:

	30 June 2005 (unaudited) RMB'000	31 December 2004 (audited) RMB'000
Trade receivables		
0 to 90 days	59,472	81,408
91 to 180 days	1,765	7,746
181 to 365 days	9,989	717
Over 365 days	—	—
	<u>71,226</u>	<u>89,871</u>
Total	<u>71,226</u>	<u>89,871</u>

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9. TRADE AND BILLS PAYABLES

An aged analysis of trade and bills payables as at 31 December 2004 and 30 June 2005, based on invoice date, is as follows:

	30 June 2005 (unaudited) RMB'000	31 December 2004 (audited) RMB'000
Trade and bill payables		
0 to 90 days	148,637	102,871
91 to 180 days	96,746	62,893
181 to 365 days	5,786	1,690
Over 365 days	1,224	1,642
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Total	252,393	169,096
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As at 30 June 2005, the Group and the Company's bills payables of RMB 185,847,000 (31 December 2004: RMB 124,822,000) were secured by the pledge of certain time deposits amounting to RMB85,411,000 (31 December 2004: RMB61,886,000)

10. CAPITAL COMMITMENTS

	30 June 2005 (unaudited) RMB'000	31 December 2004 (audited) RMB'000
Contracted, but not provided for:		
Land and buildings	—	37,144
Plant and machinery	115,389	90,640
Intangible assets	—	186
	<hr/>	<hr/>
	115,389	127,970
Authorised, but not contracted for:		
Plant and machinery	—	43,750
	<hr/>	<hr/>
	115,389	171,720
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11. CONTINGENT LIABILITIES

As at 30 June 2005, the Group and the Company did not have any significant contingent liabilities.

12. GEARING RATIO

As at 30 June 2005, the Group's gearing ratio was approximately 45.2% (31 December 2004: 47.2%) which is calculated based on the Group's total liabilities of approximately RMB310.7 million (31 December 2004: approximately RMB220.4 million) and total assets of approximately RMB687.5 million (31 December 2004: approximately RMB467.1 million).

13. Foreign Exchange Exposure

For the six months ended 30 June 2005, approximately 31.4% 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.

14. RELATED PARTY TRANSACTIONS

During the period, the Group had the following material transactions with related parties:

		Six months ended 30 June	
	Notes	2005 RMB'000	2004 RMB'000
Purchases of raw materials from a company in which a director of the Company is a shareholder	(i)	125	187
Purchases of raw materials from other related parties	(i)	18,025	15,975
Sales of raw materials to a company in which a director of the Company is a shareholder	(ii)	590	184
Sales of raw materials to other related parties	(ii)	349	344
Rental expenses paid to a company in which a director of the Company is a shareholder	(iii)	374	267
Rental income received from a company in which a director of the Company is a shareholder	(iv)	76	98
Subcontracting income from a company in which a director of the Company is a shareholder	(v)	4	62
Subcontracting income from other related parties	(v)	76	130
Subcontracting fee paid to a company in which a director of the Company is a shareholder	(v)	98	245
Subcontracting fee paid to other related parties	(v)	341	63

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 30 June 2005 was RMB148,000 (2004:Nil), which was unsecured, interest-free and had no fixed terms of repayment.
- (ii) The sales to the related parties were determined at rates mutually agreed between the Group and the related parties, which were set at cost plus 5% profit margin. The amounts due from the related parties as at 30 June 2005 was RMB 260,000 (2004: Nil), which was unsecured, interest-free and had no fixed terms of repayment.
- (iii) These transactions were determined at rates mutually agreed between the Group and the related parties, which were lower than the market value for properties of similar locations.
- (iv) These transactions were determined at rates mutually agreed between the Group and the related parties, which were fair and reasonable as compared to the properties of similar locations.
- (v) These transactions were determined at rates mutually agreed between the Group and the related parties, which were set at cost incurred plus a margin of 5%.

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

INTERIM DIVIDEND

Subject to the approval of the shareholders of the Company at the EGM to be convened by the Company on 3 October 2005, the Board proposes to declare and pay an interim dividend of RMB2 cents per share in respect of the six months ended 30 June 2005 to the shareholders of the Company whose names appear on the register of members of the Company on 2 October 2005. The register of members of the Company will be closed from 3 September 2005 to 2 October 2005, both days inclusive, during which period no share transfer shall be effected. The interim dividend as declared should not be taken as an indication of the level of profit or dividend for the full year.

The EGM will be held on 3 October 2005 at 10:00 a.m. at No. 99 Beihai Road, Shouguang City, Shandong Province, at which an ordinary resolution in relation to the proposed declaration of interim dividend will be put forth for consideration by the shareholders of the Company.

MANAGEMENT DISCUSSION AND ANALYSIS

Financial Review

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The Group has achieved an encouraging result during the period under review. For the six months ended 30 June 2005, the Group recorded an unaudited turnover of approximately RMB323,866,000 (2004: RMB215,706,000) and an unaudited net profit of approximately RMB36,556,000 (2004: RMB25,060,000). Compared to the corresponding period in the previous year, the turnover has a growth of approximately RMB108,160,000 or 50.1%, and the net profit has a growth of approximately RMB11,496,000 or 45.9%.

For the three months ended 30 June 2005, the Group recorded an unaudited turnover of approximately RMB165,866,000 (2004: RMB131,180,000) and an unaudited net profit of approximately RMB19,852,000 (2004: RMB13,288,000). Compared to the corresponding period in the previous year, the turnover has a growth of RMB34,686,000 or 26.4%, and the net profit has a growth of RMB6,564,000 or 49.4%.

Business Review

On 12 May 2005, the Company completed the placement of 108,000,000 new H Shares (the “**Placing**”). The Group applied the proceeds from the Placing for further expanding the production capacity of petroleum casing. Following the commencement of operation, it will further strengthen the Group’s core competitiveness both domestically and internationally, and lead the Group to become a pioneer in the petroleum extraction machinery industry with respect to both product development and industrial expansion.

During the period under review, the Group was engaged in the design, manufacture and sale of petroleum extraction machinery and related accessories. Its major products can be grouped into five categories, namely oil well pipes, oil well sucker rods, oil well pumps, oil well pumping machines and other petroleum extraction machinery accessories, which are primarily used in upstream petroleum extraction industry.

Following the implementation of the Group’s strategies such as enhancement in the research and development capabilities, improvement to the existing products, expansion of sales networks, at the same time leveraging on the Group’s excellent quality products and upgraded services, the Group’s products have achieved strong competitive edge in the market. The Company recorded steadily increasing domestic and overseas sales and significant growth in turnover and profits.

During the period under review, the Group’s domestic customers were mainly oil fields of the subsidiaries or branches of PetroChina Company Limited (collectively, “**PetroChina Group**”) and China Petroleum & Chemical Corporation (collectively, “**Sinopec Group**”), including Daqing Oil Field (大慶油田), Shenli Oil Field (勝利油田), Xinjiang Oil Field (新疆油田), Zhongyuan Oil Field (中原油田), Liaohe Oil Field (遼河油田) and Changqing Oil Field (長慶油田). The overseas customers of the Group were mainly distributed in North America, the United Kingdom, Russia, France, Indonesia, Middle East, Brunei, Egypt and Syria. During the period under review, the Group has successfully entered into the petroleum machinery market of Algeria, Canada and United Arab Emirates.

During the period under review, the Group’s production plant with production line for petroleum casing of 76,000 sq. m. has been fully completed. Equipment for the production line has all been ordered, with some equipment already been delivered and commenced installation. Various projects are gradually proceeding as scheduled.

Outlook

On the way forward, with the continuous growth of the global economy, demands for crude oil in the domestic and international markets will continue to grow. Demand for petroleum extraction machinery products will maintain a sustainable growth correspondingly, providing significant opportunities for development to petroleum extraction machinery manufacturers.

Strengthening of Research and Development Capability

The Group is dedicated in the optimisation of the functions and quality of the existing products and is proactively conducting research for new products. At the same time more industrial experts are recruited and collection of the latest industrial information and technology are achieved so as to maintain its technologically leading position in the industry.

Exploration of Overseas and Domestic Markets

By capitalising on the Company's listing on the GEM of the Stock Exchange and the favourable responses from the customers, the Group is more widely recognized by the overseas and domestic markets in which awareness is enhanced. The sales increases steadily every year.

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During the period under review, sales of the Group's products derived from the PRC and the overseas markets accounted for approximately 68.6% and 31.4%, respectively.

In respect of the domestic market, the Group will continue to maintain good relationships with the existing customers. Promotion activities will be regularly held in the PRC to enhance its brand-awareness. At the same time, customers will be visited regularly in order to collect their opinion and the latest market information and strengthen the quality of after-sales services, in an attempt to gain bigger market share in the PRC.

In respect of the overseas market, with the Group's successful exploration of new markets such as the Canadian and United Arab Emirates markets during the period under review, the Group has accumulated more experience in the exploration of overseas markets. The Group will continue to explore other potential markets, improve the contents of the Group's official web-site, actively promote the products and increase the percentage of the overseas sales of the Group's products.

Capacity Enhancement

Under the continued increase in the demand for petroleum, and with the continued extraction in new oil fields and continued upgrading of oil-field petroleum extraction equipment, it is expected that the exploration and production capital of petroleum and natural gas will continue to grow, pushing ahead significant development in the petroleum extraction machinery industry. The Group has long been aware of such opportunities and will continue to enhance its production capacity so as to satisfy the strong market demands.

MATERIAL ACQUISITION/DISPOSAL AND SIGNIFICANT INVESTMENT

Saved as disclosed in the subsection headed "Further information about the business" of the Company in the section headed "Statutory and General Information" in Appendix V to the prospectus of the Company dated 30 March 2004 (the "**Prospectus**") and the announcement issued by the Company on 28 April 2005 (the "**Placing Announcement**"), the Group had no material acquisition, disposal and investment. At present, the Group has no future plan for material acquisitions or disposal of significant investments other than those set out in the section headed "Statement of Business Objectives" in the Prospectus and the Placing Announcement.

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BANK FACILITIES AND PLEDGE OF ASSETS

As at 30 June 2005, the Group had bank loans amounting to RMB10,000,000. In addition, the Agricultural Bank of China (Shandong Branch), Bank of China (Shandong Branch), CITIC Industrial Bank and Weifang Commercial Bank have granted credit facilities amounting to RMB99,800,000, RMB50,000,000, RMB20,000,000 and RMB53,300,000 to the Group, respectively, which have not been utilized.

EMPLOYEES

A breakdown of the number of employees of the Group by function for six months ended 30 June 2005 were set out below:

	Six months ended 30 June	
	2005	2004
Research and development	49	43
Production	1,194	919
Quality control	78	78
Sales and marketing	52	50
Administration	156	155
	<hr/>	<hr/>
Total	1,529	1,245
	<hr/> <hr/>	<hr/> <hr/>

The Group keeps a close watch on the levels of remuneration and benefits, rewarding staff according to merit. It also offers employees training and development opportunities to upgrade their abilities.

ADVANCE TO AN ENTITY

Advance to PetroChina

Trade receivables in the amount of approximately RMB22.8 million and note receivables in the amount of approximately RMB4.1 million were owed from an independent third party, PetroChina Group, as at 30 June 2005.

Advance to Sinopec

Trade receivables in the amount of approximately RMB33.7 million and note receivables in the amount of approximately RMB4.4 million were owed from an independent third party, Sinopec Group, as at 30 June 2005.

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

COMPARISON OF BUSINESS OBJECTIVES WITH ACTUAL BUSINESS PROGRESS

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 30 June 2005, the Group has utilized the proceeds as follows:

	Use of proceeds extracted from the Prospectus	Actual amount used up to 30 June 2005	Remaining net proceeds as at 30 June 2005
	HK\$ (in million)	HK\$ (in million)	HK\$ (in million)
Research and development	5.20	5.20	1.20
Expansion of production capacity	36.00	37.30	—
Product improvement and development	22.50	22.50	0.80
Sales and marketing	1.05	1.55	0.40
Human resources	0.90	0.90	0.60
Certification	0.20	0.15	0.35
Total	<u>65.85</u>	<u>67.60</u>	<u>3.35</u>

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 utilized accordingly.

Comparisons of the business objectives with the actual business progress set out in the Prospectus of the Company for the period from 22 March 2004 to 30 June 2005 are as follows:

**Business objective as stated
in Prospectus**

Actual business progress

Research and development

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 the research and development on petroleum extraction machinery and related accessories

The planned research and development has been achieved

20 ***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	The construction of new production facilities for special seamless oil pipes has been completed
To complete the construction of new production facilities for special seamless oil well pipes and to achieve annual capacity to approximately 60,000 tons	The construction of new production facilities for special seamless oil well pipes has been completed with an annual production capacity of approximately 60,000 tons
To achieve the annual production capacity of oil well pipes to approximately 55,000 tons	The planned annual production capacity has been achieved

Production improvement and development

To develop oil well pipes which can withstand high pressure

Successfully developed oil well pipes which can withstand high pressure

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

The objective has been achieved

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 official website's content of the Group has been modified and its connection speed has been improved, therefore the opportunity to communicate with domestic and foreign customers has 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 has been established

To further explore market in North America and Middle East

The objective has been achieved

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

To renew the right to use API Monogram for oil well pumps, oil well sucker rods and oil well pipes

The renewal of the right to use API Monogram for oil well pumps, oil well sucker rods and oil well pipes has been completed

To apply for the right to use API Monogram for oil well pumping machines

The application for the right to use API Monogram for oil well pumping machines has been postponed

The net proceeds from the placing on 12 May 2005, which amounted to approximately HK\$94.80 million. As at 30 May 2005, the Group has utilized the proceeds as follows:

	Use of proceeds extracted from the Placing Announcement	Actual amount used up to 30 June 2005	Remaining net proceeds as at 30 June 2005
	HK\$ (in million)	HK\$ (in million)	HK\$ (in million)
Purchase of the production line of oil casing and related accessories	94.80	63.08	31.72

Comparisons of the business objectives with the actual business progress set out in the Placing Announcement of the Company for the period from 13 May 2005 to 30 June 2005 are as follows:

Business objective as stated

in the Placing Announcement

Actual business progress

Purchase of the production line of oil casing and related accessories

The purchase contract of the equipment for all the production lines had been signed, and parts of equipment arrived and were installed accordingly

Corporate Governance

The Company has complied throughout the period under review with the code provisions set out in the “Code on Corporate Governance Practices” contained in Appendix 15 of the GEM Listing Rules.

Audit Committee

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The Company has set up an audit committee (the “**Audit Committee**”) on 20 March 2004, and has made amendments to its written terms of reference on 18 January 2005 in compliance with the provisions as set out in Rules C.3.1 to C.3.3 of the “Code on Corporate Governance Practices” set out in Appendix 15 of the GEM Listing Rules. The primary duty of the Audit Committee is to review and supervise external auditors, financial information, financial reporting system and internal control procedures. The Audit Committee comprises of 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 discussed with the management in respect of accounting principles and practices adopted by the Group, the internal control and financial reporting matters, including review on the unaudited results as at 30 June 2005.

Remuneration Committee

The Company has set up a remuneration committee (the “**Remuneration Committee**”) on 18 January 2005. The Remuneration Committee comprises of Mr. Zhang Yun San, who is an executive Director and Mr. Qin Xue Chang, Mr. Yan Yi Zhuang and Mr. Loke Yu alias Loke Hoi Lam who are independent non-executive Directors. Mr. Loke Yu is the chairman of the Remuneration Committee. The primary duties of Remuneration Committee is to make proposals to the Board on the remuneration adjustment policy and structure in respect of the Directors and senior management of the Company and to determine the designated remuneration for all the executive Directors and senior management.

Nomination Committee

The Company has set up a nomination committee (the “**Nomination Committee**”) on 18 January 2005, which aims to ensure the procedures for the appointment of Directors to comply with the principle of fairness and transparency. The principal rights and duties of the Nomination Committee is to make regular review on the structure, number and composition (including skill, knowledge and experience) of the Board and to make recommendations to the Board on any intended change. Currently, members of the Nomination Committee include Mr. Zhang Yun San who is an executive Director and Mr. Qin Xue Chang, Mr. Yan Yi Zhuang and Mr. Loke Yu alias Loke Hoi Lam who are independent non-executive Directors. Mr. Yan Yi Zhuang is the chairman of the Nomination Committee.

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Model Code for Securities Transaction by Directors

The Company has adopted a model code of practice with standards not lower than those as required under Rules 5.48 to 5.67 of the GEM Listing Rules for securities transactions by Directors. The Company has confirmed after making due enquiries with all the Directors in accordance with the code of practice that all the Directors have complied with the standard of dealings and model code of practice in relation to the securities transaction by Directors.

DISCLOSURE OF DIRECTORS', SUPERVISORS' AND CHIEF EXECUTIVES' INTERESTS IN SHARES, UNDERLYING SHARES AND DEBENTURES

As at 30 June 2005, the interest and short positions of the Directors, supervisors (the "Supervisors") and chief executives of the Company in the shares, debentures or underlying shares 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 the Stock Exchange, will be as follows:

Long positions in shares of the Company

26	Name	Type of Interest	Number of domestic shares (Note)	Percentage of domestic shares	Percentage of total registered share capital
	Zhang En Rong	Personal	279,517,000	69.58%	43.14%
	Lin Fu Long	Personal	34,216,000	8.52%	5.28%
	Zhang Yun San	Personal	30,608,000	7.62%	4.72%
	Xie Xin Cang	Personal	21,410,000	5.33%	3.30%

(Note: All represented domestic shares)

Save as disclosed above, to the best knowledge of the Directors, none of the Directors, the Supervisors or chief executives of the Company had any interests or short position in the 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 5.48 of the GEM Listing Rules or section 352 the SFO to be entered in the register of interests reserved 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 30 June 2005.

SHARE OPTION SCHEME

The Company does not have any share option scheme.

SUBSTANTIAL SHAREHOLDERS

As at 30 June 2005, 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%	—	43.14%
Li Xiu Fen (Note 2)	Interests of spouse	34,216,000	8.52%	—	5.28%
Zhang Xin Lan (Note 3)	Interests of spouse	30,608,000	7.62%	—	4.72%
Li Bao Hui (Note 4)	Interests of spouse	21,410,000	5.33%	—	3.30%
Peter Cundill & Associates (Bermuda) Ltd. (Note 5)	Investment manager	75,792,000	—	30.78%	11.7%
RAB Energy Fund Limited (Note 5)	Investment manager	33,832,000	—	13.74%	5.22%
Cheah Cheng Hye (Note 5)	Corporate interest controlled by the significant shareholder	22,104,000	—	8.98%	3.41%
Value Partners Limited (Note 5)	Investment manager	22,104,000	—	8.98%	3.41%
Commonwealth Bank of Australia (Note 5)	Corporate interest controlled by the significant shareholder	13,052,000	—	5.30%	2.01%

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, Supervisors or chief executives of the Company who had interests or short positions in the shares, 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.

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.

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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 30 June 2005 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.

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 six months ended 30 June 2005.

DIRECTORS

As at the date of this report, the executive Directors of the Company are Mr. Zhang En Rong, Mr. Zhang Yun San, Mr. Lin Fu Long and Mr. Xie Xin Cang, the non-executive Directors are Mr. Chen Jian Xiong and Mr. Wang Ping and the independent non-executive Directors are Mr. Qin Xue Chang, Mr. Yan Yi Zhuang and Mr. Loke Yu alias Loke Hoi Lam.

By order of the Board of
Shandong Molong Petroleum Machinery Company Limited
Zhang En Rong
Chairman

Shandong, the PRC
11 August 2005