

The following is the full text of a report, prepared for the purpose of incorporation in this prospectus, received from Xinao Shijiazhuang's independent reporting accountants, KPMG, Certified Public Accountants, Hong Kong.



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Prince's Building
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Central
Hong Kong

10 October 2005

The Directors

Xinao Group Shijiazhuang Chemical Machinery Company Limited
China Everbright Capital Limited

Dear Sirs,

We set out below our report on the financial information relating to Xinao Group Shijiazhuang Chemical Machinery Company Limited ("Xinao Shijiazhuang") and its subsidiaries (hereinafter collectively referred to as the "Xinao Shijiazhuang Group") including the consolidated income statements, consolidated statements of changes in equity and consolidated cash flow statements of the Xinao Shijiazhuang Group for the year ended 31 December 2003 and the three months ended 31 March 2004 (the "Relevant Period") and the consolidated balance sheets of the Xinao Shijiazhuang Group and the balance sheets of Xinao Shijiazhuang as at 31 December 2003 and 31 March 2004, together with the notes thereto (the "Financial Information") for inclusion in the prospectus of Enric Energy Equipment Holdings Limited dated 10 October 2005 (the "Prospectus").

Xinao Shijiazhuang was established in the People's Republic of China ("PRC") on 31 December 1996. As at 31 March 2004, Xinao Shijiazhuang had the following subsidiaries:

Name of company	Place and date of establishment	Registered and paid-in capital	Direct attributable equity interest	Principal activities
Shijiazhuang Radiation Equipment Company Limited ("Radiation Equipment")	PRC 20 February 1995	RMB500,000	96%	Manufacture and sale of radiation equipment
Shijiazhuang Enric Gas Equipment Company Limited ("Enric Gas Equipment") (see note (i))	PRC 30 September 2003	RMB20,335,000	70%	Manufacture and sale of pressure vessels and provision of integrated business solutions for gas equipment

- (i) Enric Gas Equipment was established by Xinao Shijiazhuang and Enric Shijiazhuang Investment Limited ("Shijiazhuang BVI"), a related company controlled by the major shareholder of Xinao Shijiazhuang, as a Sino-foreign equity joint venture enterprise in September 2003 in the PRC. Xinao Shijiazhuang had 70% equity interests in Enric Gas Equipment since the establishment of Enric Gas equipment until 16 July 2004. Pursuant to the joint venture agreement and the related supplementary agreements, Xinao Shijiazhuang transferred certain of its assets and liabilities to Enric Gas Equipment as capital contribution on 31 March 2004. On 16 July 2004, Xinao Shijiazhuang transferred all its equity interests in Enric Gas Equipment to Shijiazhuang BVI at a cash consideration of RMB14,234,500. As Xinao Shijiazhuang's control in Enric Gas Equipment was intended to be temporary because Enric Gas Equipment was established and held exclusively with a view to its subsequent disposal in the near future, Enric Gas Equipment was excluded from consolidation in Xinao Shijiazhuang's consolidated financial statements and was classified as other investment and stated at fair value.

Basis of preparation

The Financial Information has been prepared by the directors of Xinao Shijiazhuang based on the audited financial statements or, where appropriate, unaudited management accounts of the companies of the Xinao Shijiazhuang Group. Adjustments have been made, for the purpose of this report, to restate the Financial Information to conform to the accounting policies as referred to in Section B, which are in accordance with accounting principles generally accepted in Hong Kong.

The statutory financial statements of Xinao Shijiazhuang and Radiation Equipment, which were established in the PRC, are prepared in accordance with the relevant requirements of the Accounting Standards for Business Enterprises and the Accounting Regulations for Business Enterprises issued by the PRC Ministry of Finance.

The statutory financial statements of Xinao Shijiazhuang for the year ended 31 December 2003 were audited by Shijiazhuang Hong Yuan Certified Public Accountants Co., Ltd., a firm of certified public accountants registered in the PRC.

The statutory financial statements of Radiation Equipment for the year ended 31 December 2003 were audited by Langfang Hua An Da Certified Public Accountants Co., Ltd., a firm of certified public accountants registered in the PRC.

Respective responsibilities of directors and reporting accountants

The directors of Xinao Shijiazhuang are responsible for the preparation of the Financial Information set out below which gives a true and fair view. In preparing the Financial Information which gives a true and fair view, it is fundamental that appropriate accounting policies are selected and applied consistently, that judgements and estimates are made which are prudent and reasonable and that the reasons for any significant departure from applicable accounting standards are stated.

It is our responsibility to form an independent opinion on the Financial Information.

Basis of opinion

As a basis for forming an opinion on the Financial Information of the Xinao Shijiazhuang Group for the purpose of this report, we have carried out appropriate audit procedures in respect of the audited financial statements or, where appropriate, the unaudited management accounts of the companies of the Xinao Shijiazhuang Group for the Relevant Period in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants (the "HKICPA") and carried out such additional procedures necessary in accordance with the Auditing Guideline "Prospectuses and the Reporting Accountant" issued by the HKICPA. We have not audited any financial statements of the companies of the Xinao Shijiazhuang Group in respect of any period subsequent to 31 March 2004.

An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the Financial Information. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the Financial Information, and of whether the accounting policies are appropriate to the Xinao Shijiazhuang 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 Information is free from material misstatement. In forming our opinion, we also evaluated the overall adequacy of the presentation of the Financial Information. We believe that our audit provides a reasonable basis for our opinion.

Opinion

In our opinion, for the purpose of this report, all adjustments considered necessary have been made and the Financial Information gives a true and fair view of the consolidated results and cash flows of the Xinao Shijiazhuang Group for the Relevant Period, and of the state of affairs of the Xinao Shijiazhuang Group and Xinao Shijiazhuang as at 31 December 2003 and 31 March 2004.

Unaudited financial information for the three months ended 31 March 2003

For the purpose of this report, we have also reviewed the unaudited financial information of the Xinao Shijiazhuang Group including the consolidated income statement, consolidated statement of changes in equity and consolidated cash flow statement for the three months ended 31 March 2003 (the "31 March 2003 Corresponding Information"), together with the notes thereon, for which the directors are responsible, in accordance with Statement of Auditing Standards 700 "Engagements to review interim financial reports" issued by the HKICPA. A review consists principally of making enquiries of group management and applying analytical procedures to the 31 March 2003 Corresponding Information and based thereon, assessing whether the accounting policies and presentation have been consistently applied unless otherwise disclosed. A review excludes audit procedures such as tests of controls and verification of assets, liabilities and transactions.

It is substantially less in scope than an audit and therefore provides a lower level of assurance than an audit. Accordingly we do not express an audit opinion on the 31 March 2003 Corresponding Information.

On the basis of our review of the 31 March 2003 Corresponding Information which does not constitute an audit, for the purpose of this report, we are not aware of any material modifications that should be made to the unaudited financial information presented for the three months ended 31 March 2003.

A. FINANCIAL STATEMENTS

1. Consolidated Income Statements

	Section B	Year ended 31 December 2003	Three months ended 31 March 2003 (Unaudited)	2004
	Note	RMB	RMB	RMB
Turnover	2	116,468,509	22,103,771	25,623,333
Cost of sales		<u>(96,223,328)</u>	<u>(17,840,114)</u>	<u>(21,537,935)</u>
		20,245,181	4,263,657	4,085,398
Other revenue	3	1,089,751	275,159	25,456
Selling expenses		(4,035,107)	(703,043)	(894,197)
Administrative expenses		(11,265,952)	(2,475,516)	(2,884,761)
Other net expense		<u>(84,946)</u>	<u>(66,631)</u>	<u>(1,022)</u>
Profit from operations		5,948,927	1,293,626	330,874
Finance costs	4(i)	(3,007,209)	(691,285)	(847,402)
Net unrealised gain on other investment carried at fair value		<u>–</u>	<u>–</u>	<u>18,925,050</u>
Profit from ordinary activities before taxation		2,941,718	602,341	18,408,522
Taxation	5	<u>(1,394,924)</u>	<u>(248,210)</u>	<u>(6,230,856)</u>
Profit from ordinary activities after taxation		1,546,794	354,131	12,177,666
Minority interests		<u>1,006</u>	<u>(48)</u>	<u>–</u>
Profit attributable to shareholders		<u>1,547,800</u>	<u>354,083</u>	<u>12,177,666</u>

The accompanying notes form part of the financial statements.

2. Consolidated Balance Sheets of the Xinao Shijiazhuang Group and Balance Sheets of Xinao Shijiazhuang

	Section B Note	The Xinao Shijiazhuang Group		Xinao Shijiazhuang	
		At 31 December 2003 RMB	At 31 March 2004 RMB	At 31 December 2003 RMB	At 31 March 2004 RMB
Non-current assets					
Fixed assets	9	49,199,089	3,207,720	49,148,201	3,156,832
Construction in progress	10	5,822,296	–	5,822,296	–
Long-term investments	11	808,143	808,143	808,143	808,143
Investment in a subsidiary	12	–	–	480,000	480,000
		<u>55,829,528</u>	<u>4,015,863</u>	<u>56,258,640</u>	<u>4,444,975</u>
Current assets					
Other investment	13	–	14,234,500	–	14,234,500
Inventories	14	32,760,598	32,683,752	32,327,597	32,250,751
Trade and bills receivable	15	4,590,278	1,719,510	4,535,769	1,665,001
Deposits, other receivables and prepayments	16	25,164,106	8,676,516	25,002,668	8,515,078
Amounts due from related parties	27(b)(I)	10,287,382	6,167,017	10,517,231	6,167,017
Cash at bank and in hand	17	36,721,335	7,874,447	36,389,488	7,797,302
		<u>109,523,699</u>	<u>71,355,742</u>	<u>108,772,753</u>	<u>70,629,649</u>
Current liabilities					
Bank loans	18	67,960,000	9,360,000	67,960,000	9,360,000
Trade and bills payable	19	32,298,992	8,225,117	32,149,546	8,075,671
Other payables and accrued expenses	20	12,151,223	10,708,620	11,952,923	10,510,994
Amounts due to related parties	27(b)(II)	40,890,168	17,048,747	40,890,168	17,072,925
Provisions	21	51,413	90,531	51,413	90,531
Income tax payable		1,365,789	1,201,706	1,363,004	1,198,922
		<u>154,717,585</u>	<u>46,634,721</u>	<u>154,367,054</u>	<u>46,309,043</u>
Net current (liabilities)/assets		<u>(45,193,886)</u>	<u>24,721,021</u>	<u>(45,594,301)</u>	<u>24,320,606</u>
Total assets less current liabilities		<u>10,635,642</u>	<u>28,736,884</u>	<u>10,664,339</u>	<u>28,765,581</u>
Non-current liabilities					
Deferred tax liabilities	22	–	6,230,856	–	6,230,856
Other long-term liabilities	23	7,095,807	6,788,527	7,095,807	6,788,527
		<u>7,095,807</u>	<u>13,019,383</u>	<u>7,095,807</u>	<u>13,019,383</u>
Minority interests		<u>18,052</u>	<u>18,052</u>	<u>–</u>	<u>–</u>
NET ASSETS		<u>3,521,783</u>	<u>15,699,449</u>	<u>3,568,532</u>	<u>15,746,198</u>
CAPITAL AND RESERVES					
Paid-in capital		10,346,000	10,346,000	10,346,000	10,346,000
Reserves	24	(6,824,217)	5,353,449	(6,777,468)	5,400,198
		<u>3,521,783</u>	<u>15,699,449</u>	<u>3,568,532</u>	<u>15,746,198</u>

The accompanying notes form part of the financial statements.

3. Consolidated Statements of Changes in Equity

	Year ended 31 December 2003 <i>RMB</i>	Three months ended 31 March 2003 (Unaudited) <i>RMB</i>	2004 <i>RMB</i>
Balance at the beginning of the year/period	1,973,983	1,973,983	3,521,783
Net profit for the year/period	<u>1,547,800</u>	<u>354,083</u>	<u>12,177,666</u>
Balance at the end of the year/period	<u><u>3,521,783</u></u>	<u><u>2,328,066</u></u>	<u><u>15,699,449</u></u>

The accompanying notes form part of the financial statements.

4. Consolidated Cash Flow Statements

Section B	Year ended 31 December 2003	Three months ended 31 March 2003 (Unaudited)	2004
<i>Note</i>	<i>RMB</i>	<i>RMB</i>	<i>RMB</i>
Operating activities			
Profit from ordinary activities before taxation	2,941,718	602,341	18,408,522
Adjustments for:			
Depreciation	3,418,469	833,731	1,041,104
Interest income	(802,876)	(194,185)	(13,399)
Interest charges	2,954,981	682,034	837,790
Loss on disposal of fixed assets	37,644	19,329	-
Net unrealised gain on other investment carried at fair value	-	-	(18,925,050)
	<u>8,549,936</u>	<u>1,943,250</u>	<u>1,348,967</u>
Operating profit before changes in working capital			
(Increase)/decrease in inventories	(9,437,722)	(4,661,453)	76,846
Increase in trade and bills receivable	(3,751,117)	(3,309,600)	(2,430,452)
(Increase)/decrease in deposits, other receivables and prepayments	(4,904,187)	3,053,954	(2,886,347)
Increase in amounts due from related parties	(1,337,060)	(461,691)	(38,383,698)
(Increase)/decrease in restricted bank deposits for letters of credit and bills payable	(9,654,869)	(4,758,438)	10,277,805
Increase in trade and bills payable	4,592,720	7,005,306	7,841,841
Increase in other payables and accrued expenses	3,058,741	1,037,650	3,507,321
Decrease in other long-term liabilities	(1,333,307)	(345,403)	(307,280)
Increase in amounts due to related parties	8,993,909	10,562,258	22,729,277
Increase/(decrease) in provision for product warranties	40,515	(10,898)	39,118
	<u>40,515</u>	<u>(10,898)</u>	<u>39,118</u>
Cash (used in)/generated from operations	(5,182,441)	10,054,935	1,813,398
Income tax paid	(29,135)	(3,948)	(164,083)
	<u>(5,211,576)</u>	<u>10,050,987</u>	<u>1,649,315</u>
Net cash (used in)/from operating activities			

The accompanying notes form part of the financial statements.

	Section B	Year ended 31 December 2003	Three months ended 31 March 2003 (Unaudited)	2004
	Note	RMB	RMB	RMB
Investing activities				
Payment for acquisition of fixed assets and intangible assets		(14,694,274)	(2,623,433)	(11,332,149)
Capital contribution to Enric Gas Equipment (<i>see note (i)</i>)		–	–	(92,853)
Loan repayments from a related party	27(a)(II)	11,500,000	–	–
Interest received		173,000	32,893	13,399
Advances made to related parties	27(a)(II)	(3,595,172)	(45,552)	(1,410,713)
Repayments of advances made to related parties	27(a)(II)	200,000	562,500	4,245,652
Net cash used in investing activities		<u>(6,416,446)</u>	<u>(2,073,592)</u>	<u>(8,576,664)</u>
Financing activities				
Proceeds from new bank loans		20,000,000	–	20,000,000
Repayment of bank loans		(2,900,000)	(2,900,000)	–
Interest paid		(2,954,981)	(682,034)	(837,790)
Advances received from related parties	27(a)(II)	205,038,368	–	129,374,897
Repayments of advances received from related parties	27(a)(II)	(197,973,861)	(10,630,491)	(160,178,841)
Net cash from/(used in) financing activities		<u>21,209,526</u>	<u>(14,212,525)</u>	<u>(11,641,734)</u>
Net increase/(decrease) in cash and cash equivalents		9,581,504	(6,235,130)	(18,569,083)
Cash and cash equivalents at beginning of the year/period		<u>16,862,026</u>	<u>16,862,026</u>	<u>26,443,530</u>
Cash and cash equivalents at end of the year/period		<u>26,443,530</u>	<u>10,626,896</u>	<u>7,874,447</u>

The accompanying notes form part of the financial statements.

(i) Capital contribution to Enric Gas Equipment

Enric Gas Equipment was established by Xinao Shijiazhuang and Shijiazhuang BVI as a Sino-foreign joint venture enterprise in September 2003 in the PRC. Pursuant to the joint venture agreement and related supplementary agreements, certain assets and liabilities were transferred from Xinao Shijiazhuang to Enric Gas Equipment on 31 March 2004 as capital contribution for the 70% equity interests in Enric Gas Equipment. Details of the injected assets and liabilities at values agreed by Xinao Shijiazhuang and Shijiazhuang BVI as capital contribution are set out below:

	<i>RMB</i>
Cash and cash equivalents	92,853
Trade and bills receivable	5,301,220
Other receivables and prepayments	19,373,937
Amounts due from related parties	39,669,124
Fixed assets	65,522,567
Construction in progress	9,878,561
Intangible assets	5,628,632
	<hr/>
Total assets	145,466,894
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Bank loans	78,600,000
Trade and bills payable	31,915,716
Other payables and accrued expenses	4,949,924
Amounts due to related parties	15,766,754
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Total liabilities	131,232,394
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Net assets injected as capital contributions	<u>14,234,500</u>

The values of the assets and liabilities injected to Enric Gas Equipment as capital contribution were the values mutually agreed by Xinao Shijiazhuang and Shijiazhuang BVI. In determining the agreed value of the fixed assets, Xinao Shijiazhuang and Shijiazhuang BVI had made reference to an assets valuation report prepared by an independent firm of valuers registered in the PRC. The book value of these injected fixed assets as at 31 March 2004 was RMB46,597,517. The agreed values of other assets and liabilities injected were the same as their respective book values as at 31 March 2004.

The accompanying notes form part of the financial statements.

B. NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**1. Principal accounting policies***(a) Statement of compliance*

The Financial Information has been prepared in accordance with the significant accounting policies set out below. These accounting policies are in accordance with all applicable Hong Kong Financial Reporting Standards (which includes all applicable Statements of Standard Accounting Practice and Interpretations) issued by the HKICPA and accounting principles generally accepted in Hong Kong, and have been consistently applied throughout the Relevant Period. The Financial Information also complies with the applicable disclosure provisions of the Listing Rules of the Growth Enterprises Market ("GEM") of The Stock Exchange of Hong Kong Limited ("the Stock Exchange") as applicable to accountants' reports included in Listing Documents.

(b) Basis of preparation

The measurement basis used in the preparation of the Financial Information is historical cost convention as modified for the revaluation of other investment.

(c) Subsidiaries

A subsidiary is an enterprise controlled by the Xinao Shijiazhuang Group. Control exists when Xinao Shijiazhuang has the power, directly or indirectly, to govern the financial and operating policies of an enterprise so as to obtain benefits from its activities.

An investment in a controlled subsidiary is consolidated unless it is acquired and held exclusively with a view to subsequent disposal in the near future or operates under severe long-term restrictions which significantly impair its ability to transfer funds to the Xinao Shijiazhuang Group, in which case, it is classified as other investment and stated in the consolidated balance sheet at fair value with changes in fair value recognised in the consolidated income statement as they arise.

Intra-group balances and transactions, and any unrealised profits arising from intra-group transactions, are eliminated on consolidation. Unrealised losses resulting from intra-group transactions are eliminated in the same way as unrealised gains, but only to the extent that there is no evidence of impairment.

Minority interests at the balance sheet date, being the portion of the net assets of subsidiaries attributable to equity interests that are not owned by Xinao Shijiazhuang, whether directly or indirectly through subsidiaries, are presented in the consolidated balance sheet separately from liabilities, and capital and reserves. Minority interests in the results of the Xinao Shijiazhuang Group for the period are also separately presented in the consolidated income statement.

Where losses attributable to the minority exceed the minority interest in the net assets of a subsidiary, the excess, and any further losses attributable to the minority, are charged against the Xinao Shijiazhuang Group's interest except to the extent that the minority has a binding obligation to, and is able to, make good the losses. All subsequent profits of the subsidiary are allocated to the Xinao Shijiazhuang Group until the minority's share of losses previously absorbed by the Xinao Shijiazhuang Group has been recovered.

In Xinao Shijiazhuang's balance sheet, an investment in a subsidiary is stated at cost less any impairment losses (see note 1(h)), unless it is acquired and held exclusively with a view to subsequent disposal in the near future or operates under severe long-term restrictions which significantly impair its ability to transfer funds to Xinao Shijiazhuang, in which case, it is stated at fair value with changes in fair value recognised in the income statement as they arise.

(d) *Fixed assets*

- (i) Fixed assets are stated in the balance sheet at cost less accumulated depreciation (see note 1(g)) and impairment losses (see note 1(h)). The cost of an asset comprises its purchase price, any directly attributable costs of bringing the asset to working condition and location for its intended use and the cost of borrowed funds used during the period of construction.
- (ii) Subsequent expenditure relating to a fixed asset that has already been recognised is added to the carrying amount of the asset when it is probable that future economic benefits, in excess of the originally assessed standard of performance of the existing asset, will flow to the Xinao Shijiazhuang Group. All other subsequent expenditure is recognised as an expense in the period in which it is incurred.
- (iii) Gains or losses arising from the retirement or disposal of a fixed asset are determined as the difference between the estimated net disposal proceeds and the carrying amount of the asset and are recognised in the income statement on the date of retirement or disposal.

(e) *Construction in progress*

Construction in progress represents buildings and various plants and equipment under construction and pending installation, and is stated at cost less impairment losses (see note 1(h)). Cost comprises direct costs of construction incurred and the cost of borrowed funds used during the period of construction.

Construction in progress is transferred to buildings and machinery when the asset is substantially ready for its intended use.

No depreciation is provided for construction in progress.

(f) *Intangible assets*

- (i) Expenditure on research activities, undertaken with the prospect of gaining new scientific or technical knowledge and understanding, is recognised as an expense in the period in which it is incurred.

Expenditure on development activities is capitalised if the product or process is technically and commercially feasible and the Xinao Shijiazhuang Group has sufficient resources and the intention to complete development. The expenditure capitalised includes the cost of materials, direct labour and an appropriate proportion of overheads. Capitalised development costs are stated at cost less accumulated amortisation (see note 1(g)) and impairment losses (see note 1(h)). Other development expenditure is recognised as an expense in the period in which it is incurred.

- (ii) Other intangible assets that are acquired by the Xinao Shijiazhuang Group are stated in the balance sheet at cost less accumulated amortisation (see note 1(g)) and impairment losses (see note 1(h)).
- (iii) Subsequent expenditure on an intangible asset after its purchase or completion is recognised as an expense when it is incurred unless it is probable that this expenditure will enable the asset to generate future economic benefits in excess of its originally assessed standard of performance and this expenditure can be measured and attributed to the asset reliably. If these conditions are met, the subsequent expenditure is added to the cost of the intangible asset.

(g) Depreciation and amortisation

(i) Depreciation is calculated to write off the cost of fixed assets over their estimated useful lives as follows:

- leasehold land is depreciated on a straight-line basis over the remaining term of lease;
- buildings are depreciated on a straight-line basis over the shorter of their estimated useful lives, being 30 years from the date of completion, and the unexpired terms of the leases; and
- other fixed assets are depreciated on a straight-line basis over their estimated useful lives as follows:

Machinery	10 years
Motor vehicles and office equipment	6 years

(ii) Amortisation of intangible assets is charged to the income statement on a straight-line basis over the assets' estimated useful lives of 10 years.

(h) Impairment of assets

Internal and external sources of information are reviewed at each balance sheet date to identify indications that fixed assets, construction in progress, intangible assets, investment in a subsidiary and long-term investments may be impaired or an impairment loss previously recognised no longer exists or may have decreased.

If any such indication exists, the asset's recoverable amount is estimated. For intangible assets that are not yet available for use, the recoverable amount is estimated at each balance sheet date. An impairment loss is recognised in the income statement whenever the carrying amount of such an asset exceeds its recoverable amount.

(i) Calculation of recoverable amount

The recoverable amount of an asset is the greater of its net selling price and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of time value of money and the risks specific to the asset. Where an asset does not generate cash inflows largely independent of those from other assets, the recoverable amount is determined for the smallest group of assets that generates cash inflows independently (i.e. a cash-generating unit).

(ii) Reversals of impairment losses

An impairment loss is reversed if there has been a favourable change in the estimates used to determine the recoverable amount.

A reversal of impairment losses is limited to the asset's carrying amount that would have been determined had no impairment loss been recognised in prior periods. Reversals of impairment losses are credited to the income statement in the period in which the reversals are recognised.

(i) Long-term investments

Investments held on a continuing basis for an identified long-term purpose are classified as investment securities. Investment securities are stated in the balance sheet at cost less any provisions for diminution in value. Provisions are made when the fair values have declined below the carrying amounts, unless there is evidence that the decline is temporary, and are recognised as an expense in the income statement, such provisions being determined for each investment individually.

Profits or losses on disposal of investments are determined as the difference between the estimated net disposal proceeds and the carrying amount of the investments and are accounted for in the income statement as they arise.

(j) *Inventories*

Inventories are carried at the lower of cost and net realisable value.

Cost is calculated using the weighted average cost formula and comprises all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition.

Net realisable value is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale.

When inventories are sold, the carrying amount of those inventories is recognised as an expense in the period in which the related revenue is recognised. The amount of any write-down of inventories to net realisable value and all losses of inventories are recognised as an expense in the period the write-down or loss occurs. The amount of any reversal of any write-down of inventories, arising from an increase in net realisable value, is recognised as a reduction in the amount of inventories recognised as an expense in the period in which the reversal occurs.

(k) *Cash and cash equivalents*

Cash and cash equivalents comprise cash at bank and in hand, demand deposits with banks and other financial institutions, and short-term, highly liquid investments that are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value, having been within three months of maturity at acquisition.

(l) *Employee benefits*

- (i) Salaries and annual bonuses are accrued in the period in which the associated services are rendered by employees of the Xinao Shijiazhuang Group. Where payment or settlement is deferred and the effect would be material, these amounts are stated at their present values.
- (ii) Contributions to defined contribution retirement schemes as required under relevant PRC laws and regulations are recognised as an expense in the income statement as and when incurred.

(m) *Income tax*

- (i) Income tax for the period comprises current tax and movements in deferred tax assets and liabilities. Current tax and movements in deferred tax assets and liabilities are recognised in the income statement except to the extent that they relate to items recognised directly in equity, in which case they are recognised in equity.
- (ii) Current tax is the expected tax payable on the taxable income for the period, using tax rates enacted or substantively enacted at the balance sheet date, and any adjustment to tax payable in respect of previous periods.
- (iii) Deferred tax assets and liabilities arise from deductible and taxable temporary differences respectively, being the differences between the carrying amounts of assets and liabilities for financial reporting purposes and their tax bases. Deferred tax assets also arise from unused tax losses and unused tax credits.

Apart from certain limited exceptions, all deferred tax liabilities, and all deferred tax assets to the extent that it is probable that future taxable profits will be available against which the assets can be utilised, are recognised. Future taxable profits that may support the recognition of deferred tax assets arising from deductible temporary differences include those that will arise from the reversal of existing taxable temporary differences, provided those differences relate to the same taxation authority and the same taxable entity, and are expected to reverse either in the same period as the expected reversal of the deductible temporary difference or in periods into which a tax loss arising from the deferred tax asset can be carried back or forward. The same criteria are adopted when determining whether existing taxable temporary differences support the recognition of deferred tax assets arising from unused tax losses and credits, that is, those differences are taken into account if they relate to the same taxation authority and the same taxable entity, and are expected to reverse in a period, or periods, in which the tax loss or credit can be utilised.

The limited exceptions to recognition of deferred tax assets and liabilities are those temporary differences arising from goodwill not deductible for tax purposes, negative goodwill treated as deferred income, the initial recognition of assets or liabilities that affect neither accounting nor taxable profit (provided they are not part of a business combination), and temporary differences relating to investments in subsidiaries to the extent that, in the case of taxable differences, the Xinao Shijiazhuang Group controls the timing of the reversal and it is probable that the differences will not reverse in the foreseeable future, or in the case of deductible differences, unless it is probable that they will reverse in the future.

The amount of deferred tax recognised is measured based on the expected manner of realisation or settlement of the carrying amount of the assets and liabilities, using tax rates enacted or substantively enacted at the balance sheet date. Deferred tax assets and liabilities are not discounted.

The carrying amount of a deferred tax asset is reviewed at each balance sheet date and is reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow the related tax benefit to be utilised. Any such reduction is reversed to the extent that it becomes probable that sufficient taxable profit will be available.

- (iv) Current tax balances and deferred tax balances, and movements therein, are presented separately from each other and are not offset. Current tax assets are offset against current tax liabilities, and deferred tax assets against deferred tax liabilities if, and only if, Xinao Shijiazhuang or the Xinao Shijiazhuang Group has the legally enforceable right to set off current tax assets against current tax liabilities and the following additional conditions are met:
- in the case of current tax assets and liabilities, Xinao Shijiazhuang or the Xinao Shijiazhuang Group intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously; or
 - in the case of deferred tax assets and liabilities, if they relate to income taxes levied by the same taxation authority on either:
 - the same taxable entity; or
 - different taxable entities, which, in each future period in which significant amounts of deferred tax liabilities or assets are expected to be settled or recovered, intend to realise the current tax assets and settle the current tax liabilities on a net basis or realise and settle simultaneously.

(n) *Provisions and contingent liabilities*

Provisions are recognised for liabilities of uncertain timing or amount when Xinao Shijiazhuang or the Xinao Shijiazhuang Group has a legal or constructive obligation arising as a result of a past event, it is probable that an outflow of economic benefits will be required to settle the obligation and a reliable estimate can be made. Where the time value of money is material, provisions are stated at the present value of the expenditures expected to settle the obligation.

Where it is not probable that an outflow of economic benefits will be required, or the amount cannot be estimated reliably, the obligation is disclosed as a contingent liability, unless the probability of outflow of economic benefits is remote. Possible obligations, whose existence will only be confirmed by the occurrence or non-occurrence of one or more future events are also disclosed as contingent liabilities unless the probability of outflow of economic benefits is remote.

(o) *Revenue recognition*

Provided it is probable that the economic benefits will flow to the Xinao Shijiazhuang Group and the revenue and costs, if applicable, can be measured reliably, revenue is recognised in the income statement as follows:

(i) *Sale of goods*

Revenue is recognised when goods are delivered at the customers' premises which is taken to be the point in time when the customer has accepted the goods and the related risks and rewards of ownership. Revenue excludes value added tax or other sales taxes and is after deduction of any trade discounts.

(ii) *Dividend income*

Dividend income from unlisted investments is recognised when the shareholder's right to receive payment is established.

(iii) *Interest income*

Interest income from bank deposits is accrued on a time-apportioned basis by reference to the principal outstanding and the rate applicable.

(p) *Translation of foreign currencies*

Foreign currency transactions during the period are translated into Renminbi at the exchange rates ruling at the transaction dates. Monetary assets and liabilities denominated in foreign currencies are translated into Renminbi at the exchange rates ruling at the balance sheet date. Exchange gains and losses on foreign currency transactions are dealt with in the income statement.

(q) *Borrowing costs*

Borrowing costs are expensed in the income statement in the period in which they are incurred, except to the extent that they are capitalised as being directly attributable to the acquisition, construction or production of an asset which necessarily takes a substantial period of time to get ready for its intended use or sale.

The capitalisation of borrowing costs as part of the cost of a qualifying asset commences when expenditures for the asset are being incurred, borrowing costs are being incurred and activities that are necessary to prepare the asset for its intended use or sale are in progress. Capitalisation of borrowing costs is suspended or ceases when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are interrupted or complete.

(r) Related parties

For the purposes of this report, parties are considered to be related to the Xinao Shijiazhuang Group if the Xinao Shijiazhuang Group has the ability, directly or indirectly, to control the party or exercise significant influence over the party in making financial and operating decisions, or vice versa, or where the Xinao Shijiazhuang Group and the party are subject to common control or common significant influence. Related parties may be individuals or other entities.

(s) Segment reporting

A segment is a distinguishable component of the Xinao Shijiazhuang Group that is engaged either in providing products or services (business segment), or in providing products or services within a particular economic environment (geographical segment), which is subject to risks and rewards that are different from those of other segments.

(t) Recently issued accounting standards

The HKICPA has issued a number of new and revised Hong Kong Financial Reporting Standards and Hong Kong Accounting Standards ("new HKFRSs") which are effective for accounting periods beginning on or after 1 January 2005. The Xinao Shijiazhuang Group has not early adopted these new HKFRSs in the financial statements for the Relevant Period.

2. Turnover

The Xinao Shijiazhuang Group is principally engaged in the design, manufacture and sale of pressure vessels, radiation equipment and related products. Turnover represents the sales value of goods sold after allowances for return of goods, excludes value added or other sales taxes and is after the deduction of any trade discounts.

Xinao Shijiazhuang was principally engaged in the design, manufacture and sale of pressure vessels. Upon the transfer of certain assets and liabilities to Enric Gas Equipment on 31 March 2004, Xinao Shijiazhuang ceased the production activities of pressure vessels and Xinao Shijiazhuang subsequently ceased selling pressure vessels in October 2004. Xinao Shijiazhuang commenced a new business of natural gas vehicle conversion in March 2005.

Radiation Equipment is principally engaged in the design, manufacture and sale of radiation equipment. The turnover of Radiation Equipment for the year ended 31 December 2003 and the three months ended 31 March 2003 and 2004 were RMB129,906, RMB85,566 (unaudited) and RMBnil respectively.

The Xinao Shijiazhuang Group's operations are all located in the PRC. The directors consider that the Xinao Shijiazhuang Group operates within a single business and geographical segment.

3. Other revenue

	Year ended 31 December 2003	Three months ended 31 March 2003 (Unaudited)	2004
	RMB	RMB	RMB
Other operating revenue *	286,875	80,974	12,057
Interest income from loans to a related party	629,876	161,292	–
Interest income from bank deposits	173,000	32,893	13,399
	<u>1,089,751</u>	<u>275,159</u>	<u>25,456</u>

* Other operating revenue consists mainly of income earned from the sale of steel materials left-over from production.

4. Profit from ordinary activities before taxation

Profit from ordinary activities before taxation is arrived at after charging/(crediting):

(i) Finance costs

	Year ended 31 December 2003 RMB	Three months ended 31 March 2003 (Unaudited) RMB	2004 RMB
Interest on bank loans	3,064,766	730,601	941,376
Less: borrowing costs capitalised *	<u>(109,785)</u>	<u>(48,567)</u>	<u>(103,586)</u>
	2,954,981	682,034	837,790
Finance charges	<u>52,228</u>	<u>9,251</u>	<u>9,612</u>
	<u><u>3,007,209</u></u>	<u><u>691,285</u></u>	<u><u>847,402</u></u>

* The borrowing costs have been capitalised at annual rates of 5.6%, 5.6% (unaudited) and 5.3% for the year ended 31 December 2003 and the three months ended 31 March 2003 and 2004 respectively.

(ii) Staff costs

	Year ended 31 December 2003 RMB	Three months ended 31 March 2003 (Unaudited) RMB	2004 RMB
Salaries, wages and allowances	12,920,371	2,752,539	3,008,713
Contributions to retirement schemes (see note 25)	<u>767,128</u>	<u>155,397</u>	<u>238,862</u>
	<u><u>13,687,499</u></u>	<u><u>2,907,936</u></u>	<u><u>3,247,575</u></u>

(iii) Other items

	Year ended 31 December 2003 RMB	Three months ended 31 March 2003 (Unaudited) RMB	2004 RMB
Cost of inventories #	96,223,328	17,840,114	21,537,935
Auditors' remuneration			
– audit services	9,000	7,000	6,000
Depreciation of fixed assets #	3,418,469	833,731	1,041,104
Loss on disposal of fixed assets	37,644	19,329	–
Research and development expenses	2,384,050	351,500	–
Provision for product warranties	<u>299,248</u>	<u>62,045</u>	<u>60,742</u>

Cost of inventories includes RMB7,080,451, RMB1,505,731 (unaudited) and RMB1,715,483 for the year ended 31 December 2003 and each of the three months ended 31 March 2003 and 2004 respectively, relating to staff costs and depreciation expenses, amount of which is also included in the respective total amounts disclosed separately above or in note 4(ii) for each of these types of expenses.

5. Taxation

(i) Taxation in the consolidated income statements represents:

	Year ended 31 December 2003 RMB	Three months ended 31 March 2003 (Unaudited) RMB	2004 RMB
Current taxation for the year/period	1,394,924	248,210	–
Deferred taxation (note 22)	–	–	6,230,856
	<u>1,394,924</u>	<u>248,210</u>	<u>6,230,856</u>

No provision has been made for Hong Kong Profits Tax as the Xinao Shijiazhuang Group did not earn income subject to Hong Kong Profits Tax during the Relevant Period.

Profits of Xinao Shijiazhuang and its subsidiary, Radiation Equipment, are subject to PRC income taxes, and the statutory income tax rate is 33%.

(ii) Reconciliation between income tax expenses and accounting profit:

	Year ended 31 December 2003 RMB	Three months ended 31 March 2003 (Unaudited) RMB	2004 RMB
Accounting profit before tax	<u>2,941,718</u>	<u>602,341</u>	<u>18,408,522</u>
Taxation using applicable tax rates	970,767	198,772	6,074,812
Tax effect of non-deductible expenses	<u>424,157</u>	<u>49,438</u>	<u>156,044</u>
Income tax expense	<u>1,394,924</u>	<u>248,210</u>	<u>6,230,856</u>

6. Directors' remuneration

Details of directors' remuneration for the year ended 31 December 2003 are as follows:

	Fees RMB	Salaries, allowances and benefits in kind RMB	Retirement scheme contributions RMB	Discretionary bonuses RMB	Total RMB
Directors:					
Wang Yusuo	–	–	–	–	–
Cai Hongqiu	–	–	–	–	–
Yang Yu	–	–	–	–	–
Li Jianmin	–	34,938	2,721	–	37,659
Chen Jiacheng	–	–	–	–	–
Total	<u>–</u>	<u>34,938</u>	<u>2,721</u>	<u>–</u>	<u>37,659</u>

Details of directors' remuneration for the three months ended 31 March 2003 are as follows:

	Fees (Unaudited) RMB	Salaries, allowances and benefits in kind (Unaudited) RMB	Retirement scheme contributions (Unaudited) RMB	Discretionary bonuses (Unaudited) RMB	Total (Unaudited) RMB
Directors:					
Wang Yusuo	-	-	-	-	-
Cai Hongqiu	-	-	-	-	-
Yang Yu	-	-	-	-	-
Li Jianmin	-	8,309	680	-	8,989
Chen Jiacheng	-	-	-	-	-
Total	<u>-</u>	<u>8,309</u>	<u>680</u>	<u>-</u>	<u>8,989</u>

Details of directors' remuneration for the three months ended 31 March 2004 are as follows:

	Fees (Unaudited) RMB	Salaries, allowances and benefits in kind (Unaudited) RMB	Retirement scheme contributions (Unaudited) RMB	Discretionary bonuses (Unaudited) RMB	Total (Unaudited) RMB
Directors:					
Wang Yusuo	-	-	-	-	-
Cai Hongqiu	-	-	-	-	-
Yang Yu	-	-	-	-	-
Li Jianmin	-	8,188	643	-	8,831
Chen Jiacheng	-	-	-	-	-
Total	<u>-</u>	<u>8,188</u>	<u>643</u>	<u>-</u>	<u>8,831</u>

During the Relevant Period, no emoluments were paid by the Xinao Shijiazhuang Group to the directors as an inducement to join or upon joining the Xinao Shijiazhuang Group or as compensation for loss of office. No director has waived or agreed to waive any emoluments during the Relevant Period.

7. Individuals with highest emoluments

Of the five individuals with the highest emoluments, one for the year ended 31 December 2003 and the three months ended 31 March 2003 and 2004, is a director whose emoluments are disclosed in note 6. The aggregate of the emoluments in respect of the other individuals are as follows:

	Year ended 31 December 2003 RMB	Three months ended 31 March 2003 (Unaudited) RMB	2004 RMB
Salaries, allowances and benefits in kind	143,222	34,469	34,506
Retirement scheme contributions	9,127	2,226	2,831
	<u>152,349</u>	<u>36,695</u>	<u>37,337</u>

The emoluments of the four individuals, for the year ended 31 December 2003 and each of the three months ended 31 March 2003 and 2004, with the highest emoluments are within the following bands:

	Year ended 31 December 2003	Three months ended 31 March 2003 (Unaudited)	2004
HK\$ Nil – HK\$1,000,000	<u>4</u>	<u>4</u>	<u>4</u>

During the Relevant Period, no emoluments were paid by the Xinao Shijiazhuang Group to the five highest paid individuals as an inducement to join or upon joining the Xinao Shijiazhuang Group or as compensation for loss of office.

8. Dividends

No dividend has been paid or declared by Xinao Shijiazhuang during the Relevant Period.

9. Fixed assets

The fixed assets of the Xinao Shijiazhuang Group for the Relevant Period are as follows:

	Leasehold land RMB	Buildings RMB	Machinery RMB	Motor vehicles RMB	Office equipment RMB	Total RMB
Cost						
Balance at 1 January 2003	7,913,462	22,622,770	27,106,783	3,481,067	1,109,423	62,233,505
Additions	-	1,929,859	1,578,383	64,231	232,719	3,805,192
Disposals	-	(80,400)	-	(177,044)	-	(257,444)
Transfers from construction in progress	-	2,068,560	5,768,773	-	-	7,837,333
Balance at 31 December 2003	<u>7,913,462</u>	<u>26,540,789</u>	<u>34,453,939</u>	<u>3,368,254</u>	<u>1,342,142</u>	<u>73,618,586</u>
Balance at 1 January 2004	7,913,462	26,540,789	34,453,939	3,368,254	1,342,142	73,618,586
Additions	-	332,795	1,061,579	230,368	22,510	1,647,252
Capital contribution to Enric Gas Equipment	(7,156,373)	(24,180,058)	(35,436,768)	-	(1,124,388)	(67,897,587)
Balance at 31 March 2004	<u>757,089</u>	<u>2,693,526</u>	<u>78,750</u>	<u>3,598,622</u>	<u>240,264</u>	<u>7,368,251</u>
Accumulated depreciation						
Balance at 1 January 2003	(633,072)	(6,508,413)	(11,734,092)	(1,975,650)	(369,601)	(21,220,828)
Charge for the year	(158,268)	(894,419)	(1,816,568)	(376,797)	(172,417)	(3,418,469)
Written back on disposal	-	62,085	-	157,715	-	219,800
Balance at 31 December 2003	<u>(791,340)</u>	<u>(7,340,747)</u>	<u>(13,550,660)</u>	<u>(2,194,732)</u>	<u>(542,018)</u>	<u>(24,419,497)</u>
Balance at 1 January 2004	(791,340)	(7,340,747)	(13,550,660)	(2,194,732)	(542,018)	(24,419,497)
Charge for the period	(26,378)	(274,170)	(615,763)	(82,567)	(42,226)	(1,041,104)
Written back on capital contribution to Enric Gas Equipment	739,486	5,982,894	14,089,858	-	487,832	21,300,070
Balance at 31 March 2004	<u>(78,232)</u>	<u>(1,632,023)</u>	<u>(76,565)</u>	<u>(2,277,299)</u>	<u>(96,412)</u>	<u>(4,160,531)</u>
Net book value						
At 31 December 2003	<u>7,122,122</u>	<u>19,200,042</u>	<u>20,903,279</u>	<u>1,173,522</u>	<u>800,124</u>	<u>49,199,089</u>
At 31 March 2004	<u>678,857</u>	<u>1,061,503</u>	<u>2,185</u>	<u>1,321,323</u>	<u>143,852</u>	<u>3,207,720</u>

The Xinao Shijiazhuang Group's leasehold land has remaining terms of 44 years as at 31 March 2004.

The fixed assets of Xiniao Shijiazhuang for the Relevant Period are as follows:

	Leasehold land RMB	Buildings RMB	Machinery RMB	Motor vehicles RMB	Office equipment RMB	Total RMB
Cost						
Balance at 1 January 2003	7,913,462	22,622,770	27,028,033	3,423,767	1,109,423	62,097,455
Additions	-	1,929,859	1,578,383	64,231	228,099	3,800,572
Disposals	-	(80,400)	-	(177,044)	-	(257,444)
Transfers from construction in progress	-	2,068,560	5,768,773	-	-	7,837,333
Balance at 31 December 2003	7,913,462	26,540,789	34,375,189	3,310,954	1,337,522	73,477,916
Balance at 1 January 2004	7,913,462	26,540,789	34,375,189	3,310,954	1,337,522	73,477,916
Additions	-	332,795	1,061,579	230,368	22,510	1,647,252
Capital contribution to Enric Gas Equipment	(7,156,373)	(24,180,058)	(35,436,768)	-	(1,124,388)	(67,897,587)
Balance at 31 March 2004	757,089	2,693,526	-	3,541,322	235,644	7,227,581
Accumulated depreciation						
Balance at 1 January 2003	(633,072)	(6,508,413)	(11,657,527)	(1,968,772)	(369,601)	(21,137,385)
Charge for the year	(158,268)	(894,419)	(1,816,568)	(370,889)	(171,986)	(3,412,130)
Written back on disposal	-	62,085	-	157,715	-	219,800
Balance at 31 December 2003	(791,340)	(7,340,747)	(13,474,095)	(2,181,946)	(541,587)	(24,329,715)
Balance at 1 January 2004	(791,340)	(7,340,747)	(13,474,095)	(2,181,946)	(541,587)	(24,329,715)
Charge for the period	(26,378)	(274,170)	(615,763)	(82,567)	(42,226)	(1,041,104)
Written back on capital contribution to Enric Gas Equipment	739,486	5,982,894	14,089,858	-	487,832	21,300,070
Balance at 31 March 2004	(78,232)	(1,632,023)	-	(2,264,513)	(95,981)	(4,070,749)
Net book value						
At 31 December 2003	7,122,122	19,200,042	20,901,094	1,129,008	795,935	49,148,201
At 31 March 2004	678,857	1,061,503	-	1,276,809	139,663	3,156,832

Xiniao Shijiazhuang's leasehold land has remaining terms of 44 years as at 31 March 2004.

10. Construction in progress – the Xinao Shijiazhuang Group and Xinao Shijiazhuang

	Year ended 31 December 2003 RMB	Three months ended 31 March 2004 RMB
Cost		
Opening balance	2,770,547	5,822,296
Additions	10,889,082	4,056,265
Transfers to fixed assets	(7,837,333)	–
Capital contribution to Enric Gas Equipment	–	(9,878,561)
Ending balance	<u>5,822,296</u>	<u>–</u>

11. Long-term investments – the Xinao Shijiazhuang Group and Xinao Shijiazhuang

	At 31 December 2003 RMB	At 31 March 2004 RMB
Unlisted equity investments, at cost	<u>808,143</u>	<u>808,143</u>

12. Investment in a subsidiary – Xinao Shijiazhuang

The balances represent investment in Radiation Equipment which is a controlled subsidiary as defined under note 1(c) and have been consolidated into the Xinao Shijiazhuang Group financial statements.

13. Other investment – the Xinao Shijiazhuang Group and Xinao Shijiazhuang

	At 31 December 2003 RMB	At 31 March 2004 RMB
Unlisted, at fair value	<u>–</u>	<u>14,234,500</u>

This represents Xinao Shijiazhuang's 70% equity interests in Enric Gas Equipment. As Xinao Shijiazhuang's control in Enric Gas Equipment was intended to be temporary because Enric Gas Equipment was established and held exclusively with a view to its subsequent disposal in the near future, Enric Gas Equipment was not consolidated in Xinao Shijiazhuang's consolidated financial statements.

14. Inventories

	The Xinao Shijiazhuang Group		Xinao Shijiazhuang	
	At 31	At 31	At 31	At 31
	December	March	December	March
	2003	2004	2003	2004
	RMB	RMB	RMB	RMB
Raw materials	12,614,655	11,621,510	12,546,296	11,553,151
Work in progress	10,113,792	11,819,234	9,958,008	11,663,450
Finished goods	10,032,151	9,243,008	9,823,293	9,034,150
	<u>32,760,598</u>	<u>32,683,752</u>	<u>32,327,597</u>	<u>32,250,751</u>

No inventories were stated at net realisable value as at 31 December 2003 and 31 March 2004.

15. Trade and bills receivable

All of the trade and bills receivable (net of allowance for bad and doubtful debts) are expected to be recovered within one year.

An ageing analysis of trade and bills receivable is as follows:

	The Xinao Shijiazhuang Group		Xinao Shijiazhuang	
	At 31	At 31	At 31	At 31
	December	March	December	March
	2003	2004	2003	2004
	RMB	RMB	RMB	RMB
Aged within 3 months	4,437,801	–	4,437,801	–
Aged between 3 to 6 months	–	1,665,001	–	1,665,001
Aged over 1 year	152,477	54,509	97,968	–
	<u>4,590,278</u>	<u>1,719,510</u>	<u>4,535,769</u>	<u>1,665,001</u>

In general, debts are due for payment upon billing. Subject to negotiation, credit terms within a range of three to twelve months are available to certain customers with well-established trading and payment records on a case-by-case basis.

16. Deposits, other receivables and prepayments

	The Xinao Shijiazhuang Group		Xinao Shijiazhuang	
	At 31	At 31	At 31	At 31
	December	March	December	March
	2003	2004	2003	2004
	RMB	RMB	RMB	RMB
Advances to suppliers	13,927,704	328,879	13,921,656	322,831
Deposits for construction work and equipment purchase	1,828,684	–	1,828,684	–
Staff advances	934,584	15,000	934,584	15,000
Cash advances to a third party *	7,913,590	7,913,590	7,913,590	7,913,590
Recoverable input value added tax	33,726	263,657	33,726	263,657
Others	525,818	155,390	370,428	–
	<u>25,164,106</u>	<u>8,676,516</u>	<u>25,002,668</u>	<u>8,515,078</u>

* Cash advances to a third party were unsecured, interest-free and have been subsequently settled in July 2004.

17. Cash at bank and in hand

	The Xinao Shijiazhuang Group		Xinao Shijiazhuang	
	At 31	At 31	At 31	At 31
	December	March	December	March
	2003	2004	2003	2004
	RMB	RMB	RMB	RMB
Cash in hand and demand deposits	26,443,530	7,874,447	26,111,683	7,797,302
Restricted bank deposits for letters of credit and bills payable	10,277,805	–	10,277,805	–
	<u>36,721,335</u>	<u>7,874,447</u>	<u>36,389,488</u>	<u>7,797,302</u>

RMB is not a freely convertible currency and the remittance of funds out of the PRC is subject to the exchange restriction imposed by the PRC Government.

18. Bank loans – the Xinao Shijiazhuang Group and Xinao Shijiazhuang

	At 31	At 31
	December	March
	2003	2004
	RMB	RMB
Bank loans – guaranteed	<u>67,960,000</u>	<u>9,360,000</u>

The above bank loans are guaranteed by Xinao Group Company Limited, a related party controlled by the major shareholder of Xinao Shijiazhuang. The annual rate of interest charged on the bank loans ranged from 5.3% to 6.5% and 5.1% to 5.8% for the year ended 31 December 2003 and the three months ended 31 March 2004 respectively.

19. Trade and bills payable

	The Xinao Shijiazhuang Group		Xinao Shijiazhuang	
	At 31	At 31	At 31	At 31
	December	March	December	March
	2003	2004	2003	2004
	RMB	RMB	RMB	RMB
Trade creditors	11,583,021	8,225,117	11,433,575	8,075,671
Bills payable	20,715,971	–	20,715,971	–
	<u>32,298,992</u>	<u>8,225,117</u>	<u>32,149,546</u>	<u>8,075,671</u>

An ageing analysis of trade and bills payable is as follows:

	The Xinao Shijiazhuang Group		Xinao Shijiazhuang	
	At 31	At 31	At 31	At 31
	December	March	December	March
	2003	2004	2003	2004
	RMB	RMB	RMB	RMB
Due within 3 months or on demand	809,226	5,060,097	809,226	5,060,097
Due after 3 months but within 6 months	21,680,419	781,630	21,680,419	781,630
Due after 6 months but within 1 year	2,945,001	948,947	2,945,001	948,947
Due over 1 year	6,864,346	1,434,443	6,714,900	1,284,997
	<u>32,298,992</u>	<u>8,225,117</u>	<u>32,149,546</u>	<u>8,075,671</u>

All of the trade and other payables are expected to be settled within one year.

20. Other payables and accrued expenses

	The Xinao Shijiazhuang Group		Xinao Shijiazhuang	
	At 31	At 31	At 31	At 31
	December	March	December	March
	2003	2004	2003	2004
	RMB	RMB	RMB	RMB
Advances from customers	6,445,656	8,103,211	6,385,593	8,043,149
Employees' bonus and welfare	1,746,614	897,313	1,706,119	856,818
Compensation to laid-off employees payable				
within one year	1,333,307	1,295,184	1,333,307	1,295,184
Payable for construction work	2,127,615	–	2,127,615	–
Accrued utilities expenses	–	197,412	–	197,412
Others	498,031	215,500	400,289	118,431
	<u>12,151,223</u>	<u>10,708,620</u>	<u>11,952,923</u>	<u>10,510,994</u>

21. Provision for product warranties – the Xinao Shijiazhuang Group and Xinao Shijiazhuang

	Year ended 31 December 2003 RMB	Three months ended 31 March 2004 RMB
Opening balance	10,898	51,413
Provisions made	299,248	60,742
Provisions utilised	<u>(258,733)</u>	<u>(21,624)</u>
Ending balance	<u>51,413</u>	<u>90,531</u>

Under the normal terms of Xinao Shijiazhuang's sales agreements, Xinao Shijiazhuang will rectify any product defects arising within one year of the date of sale. Provision is therefore made for the best estimate of the expected settlement under these agreements in respect of sales made within the one year prior to the balance sheet date.

22. Deferred tax liabilities/(assets) – the Xinao Shijiazhuang Group and Xinao Shijiazhuang

The components of deferred tax liabilities/(assets) are set out below:

	At 31 December 2003 RMB	At 31 March 2004 RMB
Net unrealised gain on investment in Enric Gas Equipment carried at fair value	–	6,245,267
Tax losses	<u>–</u>	<u>(14,411)</u>
	<u>–</u>	<u>6,230,856</u>

The movements of deferred tax liabilities/(assets) during the Relevant Period are as follows:

	Tax losses RMB	Net unrealised gain on investment in Enric Gas Equipment carried at fair value RMB	Total RMB
Balance at 1 January 2004	–	–	–
Recognised in consolidated income statement (<i>see note 5(i)</i>)	<u>(14,411)</u>	<u>6,245,267</u>	<u>6,230,856</u>
Balance at 31 March 2004	<u>(14,411)</u>	<u>6,245,267</u>	<u>6,230,856</u>

23. Other long-term liabilities – the Xinao Shijiazhuang Group and Xinao Shijiazhuang

This represents compensation payable to laid-off employees which are payable after one year.

24. Reserves

The reserves of the Xinao Shijiazhuang Group for the Relevant Period are as follows:

	Capital Surplus RMB Note (i)	Retained profits/ (accumulated losses) RMB	Total RMB
At 1 January 2003	3,200,000	(11,572,017)	(8,372,017)
Profit for the year	—	1,547,800	1,547,800
At 31 December 2003	3,200,000	(10,024,217)	(6,824,217)
Profit for the period	—	12,177,666	12,177,666
At 31 March 2004	<u>3,200,000</u>	<u>2,153,449</u>	<u>5,353,449</u>

The reserves of Xinao Shijiazhuang for the Relevant Period are as follows:

	Capital Surplus RMB Note (i)	Retained profits/ (accumulated losses) RMB	Total RMB
At 1 January 2003	3,200,000	(11,549,421)	(8,349,421)
Profit for the year	—	1,571,953	1,571,953
At 31 December 2003	3,200,000	(9,977,468)	(6,777,468)
Profit for the period	—	12,177,666	12,177,666
At 31 March 2004	<u>3,200,000</u>	<u>2,200,198</u>	<u>5,400,198</u>

(i) Capital surplus

Capital surplus represents cash donations made by Xinao Group Company Limited to Xinao Shijiazhuang in 2002.

(ii) Distributable reserves

The distributable reserves at 31 December 2003 and 31 March 2004 of the Xinao Shijiazhuang Group, which were determined in accordance with the PRC accounting rules and regulations, were RMB nil.

25. Retirement benefits

Xinao Shijiazhuang and its subsidiary, Radiation Equipment, operating in the PRC participate in government pension schemes whereby they are required to pay annual contributions at the rate of 20% of the basic salaries of their employees. Under these schemes, retirement benefits of the existing and retired employees are payable by the relevant authorities and Xinao Shijiazhuang and Radiation Equipment have no further obligations beyond the annual contributions.

Xinao Shijiazhuang and Radiation Equipment do not operate any other schemes for retirement benefits provided to their employees.

26. Commitments – the Xinao Shijiazhuang Group and Xinao Shijiazhuang

Capital commitments in respect of capital expenditure at 31 December 2003 and 31 March 2004 not provided for in the Financial Information are as follows:

	At 31 December 2003 RMB	At 31 March 2004 RMB
Contracted for	5,215,778	–
Authorised but not contracted for	–	–
	<u>5,215,778</u>	<u>–</u>

27. Material related party transactions

(a) Transactions

		Year ended 31 December 2003 RMB	Three months ended 31 March 2003 (Unaudited) RMB	2004 RMB
(I) Trade				
Sales	(i)	12,594,439	2,790,000	5,104,401
Purchases	(ii)	5,774,799	1,363,662	8,054,350
(II) Non-trade				
Interest income on				
loans to a related party	(iii)	629,876	161,292	–
Repayment of loans to a related party	(iii)	11,500,000	–	–
Cash advances to related parties	(iv)	3,595,172	45,552	1,410,713
Repayments of cash advances to related parties	(iv)	200,000	562,500	4,245,652
Cash advances from related parties	(v)	205,038,368	–	129,374,897
Repayments of cash advances from related parties	(v)	197,973,861	10,630,491	160,178,841

Notes:

- (i) Sales to related parties mainly represent the sale of pressure vessels and related products. The selling prices are determined based on prevailing price of similar products to independent third party customers.
- (ii) Purchases from related parties mainly represent purchases of raw materials.
- (iii) These relate to loans to Xinao Group Company Limited. These loans carried interest at annual rates ranging from 5.3% to 5.8% for the year ended 31 December 2003.

- (iv) Cash advances to related parties for the year ended 31 December 2003 and the three months ended 31 March 2003 and 2004 are as follows:

	Year ended	Three months	
	31 December	ended 31 March	
	2003	2003	2004
		(Unaudited)	
Xinao Group Company Limited	–	–	1,306,953
Xinao Group Solar Energy Company Limited	1,118	–	103,760
Langfang Xinao Gas Company Limited	20,025	–	–
Hebei Veyong Group Company Limited	1,632,749	–	–
Enric (Bengbu) Compressors Company Limited	1,941,280	–	–
Shijiazhuang Xinao Gas Company Limited	–	45,552	–
Total	<u>3,595,172</u>	<u>45,552</u>	<u>1,410,713</u>

The above entities are companies controlled by Xinao Shijiazhuang's major shareholder, who is also a director of Xinao Shijiazhuang.

Cash advances to related parties are unsecured, interest-free and have no fixed terms of repayment.

- (v) Cash advances from related parties are unsecured, interest-free and have no fixed terms of repayment.
- (vi) Xinao Shijiazhuang had bank loans of RMB67,960,000 and RMB9,360,000 guaranteed by Xinao Group Company Limited as at 31 December 2003 and 31 March 2004 respectively (see note 18).

The directors of Xinao Shijiazhuang are of the opinion that the above transactions with related parties were conducted on normal commercial terms and in the ordinary and usual course of the Xinao Shijiazhuang Group's business.

(b) *Balances with related parties*

- (I) Amounts due from related parties are as follows:

	Notes	The Xinao		Xinao Shijiazhuang	
		Shijiazhuang Group		Xinao Shijiazhuang	
		At 31	At 31	At 31	At 31
		December	March	December	March
		2003	2004	2003	2004
		RMB	RMB	RMB	RMB
(A) Trade balances	(i)	2,552,768	1,267,342	2,552,768	1,267,342
(B) Non-trade balances					
• Interest receivables					
from loans	(ii)	1,006,222	1,006,222	1,006,222	1,006,222
• Cash advances	(iii)	6,728,392	3,893,453	6,958,241	3,893,453
Total		<u>10,287,382</u>	<u>6,167,017</u>	<u>10,517,231</u>	<u>6,167,017</u>

Notes:

- (i) This represents the sales of pressure vessels and related products to related parties.
- (ii) These relate to loans to Xinao Group Company Limited. These loans carried interest at annual rates ranging from 5.3% to 5.8% for the year ended 31 December 2003. The maximum balance of the loans to this related party, which is controlled by Xinao Shijiazhuang's major shareholder who is also a director of Xinao Shijiazhuang, and the related interest receivables were in aggregate RMB12,506,222 and RMB1,006,222 for the year ended 31 December 2003 and the three months ended 31 March 2004, respectively.
- (iii) Cash advances to related parties are as follows:

	The Xinao Shijiazhuang Group		Xinao Shijiazhuang	
	At 31 December 2003	At 31 March 2004	At 31 December 2003	At 31 March 2004
	RMB	RMB	RMB	RMB
Xinao Group Company Limited	-	1,306,953	-	1,306,953
Xinao Group Solar Energy Company Limited	1,118	-	1,118	-
Langfang Xinao Gas Company Limited	20,025	-	20,025	-
Hebei Veyong Group Company Limited	1,432,749	-	1,432,749	-
Beijing Dingchangyuan Energy Resources Equipment Company Limited	2,586,500	2,586,500	2,586,500	2,586,500
Enric (Bengbu) Compressors Company Limited	2,688,000	-	2,688,000	-
Radiation Equipment	-	-	229,849	-
	<u>6,728,392</u>	<u>3,893,453</u>	<u>6,958,241</u>	<u>3,893,453</u>

The above entities are companies controlled by Xinao Shijiazhuang's major shareholder who is also a director of Xinao Shijiazhuang. The maximum balances of these cash advances during the year ended 31 December 2003 and the three months ended 31 March 2004 are as follows:

	Year ended 31 December 2003	Three months ended 31 March 2004
	RMB	RMB
Xinao Group Company Limited	-	1,306,953
Xinao Group Solar Energy Company Limited	1,118	104,878
Langfang Xinao Gas Company Limited	20,025	20,025
Hebei Veyong Group Company Limited	1,632,749	1,632,749
Beijing Dingchangyuan Energy Resources Equipment Company Limited	2,586,500	2,586,500
Enric (Bengbu) Compressors Company Limited	2,688,000	2,688,000
Shijiazhuang Xinao Gas Company Limited	45,552	-

Cash advances to related parties are unsecured, interest-free and have no fixed terms of repayment.

(II) Amounts due to related parties are as follows:

		<i>Notes</i>	The Xinao		Xinao Shijiazhuang	
			Shijiazhuang Group			
			At 31	At 31	At 31	At 31
			December	March	December	March
			2003	2004		
			RMB	RMB	RMB	RMB
(A)	Trade balances	(i)	7,891,828	14,854,351	7,891,828	14,854,351
(B)	Non-trade balances					
	• Cash advances	(ii)	<u>32,998,340</u>	<u>2,194,396</u>	<u>32,998,340</u>	<u>2,218,574</u>
	Total		<u><u>40,890,168</u></u>	<u><u>17,048,747</u></u>	<u><u>40,890,168</u></u>	<u><u>17,072,925</u></u>

Notes:

- (i) This represents purchases of raw materials and receipts in advance for sale of goods.
- (ii) Cash advances from related parties are unsecured, interest-free and have no fixed terms of repayment.

28. Ultimate holding company

The directors consider the ultimate holding company of Xinao Shijiazhuang at 31 March 2004 to be Xinao Group Company Limited, which is established in the PRC.

C. SUBSEQUENT EVENTS

The following events took place subsequent to 31 March 2004:

1. Disposal of the investment in Enric Gas Equipment

On 21 June 2004, Xinao Shijiazhuang entered into an equity transfer agreement with Shijiazhuang BVI, under which Xinao Shijiazhuang transferred all of its equity interests in Enric Gas Equipment to Shijiazhuang BVI at a cash consideration of RMB14,234,500. The transfer of equity interests in Enric Gas Equipment was approved by the Management Committee of Shijiazhuang High Technology Industry Development Zone on 16 July 2004.

2. Liquidation of Radiation Equipment

On 5 July 2004, Radiation Equipment's shareholders resolved to put Radiation Equipment into liquidation. At the date of this report, the liquidation process is still in progress.

D. SUBSEQUENT FINANCIAL STATEMENTS

No audited financial statements have been prepared by Xinao Shijiazhuang or by any of the companies of the Xinao Shijiazhuang Group in accordance with accounting principles generally accepted in Hong Kong in respect of any period subsequent to 31 March 2004.

Yours faithfully,
KPMG
Certified Public Accountants
Hong Kong