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 liacility)

(Stock Code: 8261)

ANNUAL RESULTS ANNOUNCEMENT FOR THE YEAR ENDED 31 DECEMBER 2005

Characteristics of the Growth Enterprise Market ("GEM") of The Stock Exchange of Hong Kong Limited (the "Stock Exchange")

GEM has been established as a market designed to accommodate companies to which a high investment risk may be attached. In particular, companies may list on GEM with neither a track record of profitability nor any obligation to forecast future profitability. Furthermore, there may be risks arising out of the emerging nature of companies listed on GEM and the business sectors or countries in which the companies operate. Prospective investors should be aware of the potential risks of investing in such companies and should make the decision to invest only after due and careful consideration. The greater risk profile and other characteristics of GEM mean that it is a market more suited to professional and other sophisticated investors.

Given the emerging nature of companies listed on GEM, there is a risk that securities traded on GEM may be more susceptible to high market volatility than securities traded on the Main Board of the Stock Exchange and no assurance is given that there will be a liquid market in the securities traded on GEM.

The principal means of information dissemination on GEM is publication on the Internet website operated by the Stock Exchange. GEM-listed companies are not generally required to issue paid reports in gazetted newspapers. Accordingly, prospective investors should note that they need to have access to the GEM website at "www.hkgem.com" in order to obtain up-to-date information on GEM-listed issuers.

This announcement, for which the directors of Shandong Molong Petroleum Machinery Company Limited (the "Company") collectively and individually accept full responsibility, includes particulars given in compliance with the Rules Governing the Listing of Securities on the GEM of the Stock Exchange (the "GEM Listing Rules") for the purpose of giving information with regard to the Company. The directors of the Company (the "Directors"), having made all reasonable enquiries, confirm that, to the best of their knowledge and belief: (1) the information contained in this announcement 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 announcement misleading; and (3) all opinions expressed in this announcement have been arrived at after due and careful consideration and are founded on bases and assumptions that are fair and reasonable.

HIGHLIGHTS

- The H Shares of the Company were successfully listed on GEM of the Stock Exchange on 15 April 2004.
- For the year ended 31 December 2005, the revenue of the Company and its subsidiaries (collectively, the "Group") increased significantly to approximately RMB776,522,000, which represents an approximate 59.23% growth as compared to the previous year, and the Group's net profit from ordinary activities attributable to shareholders increased by approximately 38.88% to approximately RMB85,227,000 as compared to the previous year.
- Earnings per share of the Group was approximately RMB0.141 for the year ended 31 December 2005.
- The board of Directors (the "Board") has recommended a final dividend of RMB0.017 per share which is subject to approval by shareholders of the Company in the annual general meeting to be held on 12 May 2006.

THE FINANCIAL STATEMENTS

Results

The Directors are pleased to announce the audited consolidated results of the Group for the year ended 31 December 2005, together with the comparative audited figures for the year 2004, as follows:

Consolidated Income Statement

Year ended 31 December 2005

	Notes	**2005**	2004
		RMB'000	RMB'000
REVENUE	3	**776,522**	487,688
Cost of sales		**(596,113)**	(391,030)
Gross profit		**180,409**	96,658
Other income and gain	3	**14,146**	15,458
Selling and distribution costs		**(24,853)**	(20,128)
Administrative expenses		**(33,162)**	(14,300)
Other expenses		**(17,577)**	(7,540)
Finance costs	4	**(3,444)**	(4,572)
PROFIT BEFORE TAX	5	**115,519**	65,576
Tax	6	**(27,271)**	(1,485)
PROFIT FOR THE YEAR		**88,248**	64,091
Attributable to:			
Equity holders of the parent	7	**85,227**	61,366
Minority interests		**3,021**	2,725
		88,248	64,091
DIVIDENDS	8		
Interim		**12,982**	10,806
Proposed final		**11,016**	8,100
		23,998	18,906
EARNINGS PER SHARE ATTRIBUTABLE TO ORDINARY EQUITY HOLDERS OF THE PARENT – Basic (RMB)	9	**0.141**	0.122

Consolidated Balance Sheet

31 December 2005

	Notes	2005 RMB'000	2004 RMB'000 (Restated)
NON-CURRENT ASSETS			
Property, plant and equipment		**326,114**	124,330
Investment properties		**8,037**	—
Prepaid land lease payments		**20,201**	8,872
Intangible asset		**273**	112
Available-for-sale equity investment/ long term investment		**50**	50
Deferred tax assets		**5,238**	—
Total non-current assets		**359,913**	133,364
CURRENT ASSETS			
Inventories		**213,854**	140,284
Trade receivables		**75,744**	89,871
Notes receivable		**15,164**	—
Prepayments, deposits and other receivables		**14,681**	15,577
Due from related parties		**21,977**	—
Pledged deposits		**147,630**	61,886
Cash and bank balances		**110,166**	26,077
Total current assets		**599,216**	333,695
CURRENT LIABILITIES			
Trade and bills payables		**421,189**	169,096
Other payables and accruals		**38,877**	20,206
Tax payable		**23,355**	302
Interest-bearing bank loans		**50,000**	30,000
Due to related parties		**10,642**	811
Total current liabilities		**544,063**	220,415
NET CURRENT ASSETS		**55,153**	113,280
TOTAL ASSETS LESS CURRENT LIABILITIES		**415,066**	246,644
NET ASSETS		**415,066**	246,644
EQUITY			
EQUITY ATTRIBUTABLE TO EQUITY HOLDERS OF THE PARENT			
Issued capital		**64,800**	54,000
Reserves	10	**334,359**	183,454
Proposed final dividend	8	**11,016**	8,100
		410,175	245,554
MINORITY INTERESTS		**4,891**	1,090
TOTAL EQUITY		**415,066**	246,644

Consolidated Statement of Changes in Equity

Year ended 31 December 2005

	Attributable to equity holders of the parent									
	Issued share capital	Capital reserve	Statutory reserve fund*	Statutory welfare fund*	Retained profits	Subtotal of reserves	Proposed final dividend	Total	Minority interests	Total Equity
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
At 1 January 2004	40,500	20,627	7,583	4,370	41,005	73,585	—	114,085	4,814	118,899
Issue of shares	13,500	89,169	—	—	—	89,169	—	102,669	—	102,669
Share issue expenses	—	(21,760)	—	—	—	(21,760)	—	(21,760)	—	(21,760)
Net profit for the year (as restated)	—	—	—	—	61,366	61,366	—	61,366	2,725	64,091
Liquidation of a subsidiary	—	—	—	—	—	—	—	—	(6,449)	(6,449)
Transfer from retained profits to statutory funds	—	—	8,456	3,649	(12,105)	—	—	—	—	—
Interim 2004 dividend	—	—	—	—	(10,806)	(10,806)	—	(10,806)	—	(10,806)
Proposed final 2004 dividend	—	—	—	—	(8,100)	(8,100)	8,100	—	—	—
At 31 December 2004	54,000	88,036	16,039	8,019	71,360	183,454	8,100	245,554	1,090	246,644
At 1 January 2005	54,000	88,036	16,039	8,019	71,360	183,454	8,100	245,554	1,090	246,644
Final 2004 dividend declared	—	—	—	—	—	—	(8,100)	(8,100)	—	(8,100)
Issue of shares	10,800	94,831	—	—	—	94,831	—	105,631	—	105,631
Share issue expenses	—	(5,155)	—	—	—	(5,155)	—	(5,155)	—	(5,155)
Net profit for the year	—	—	—	—	85,227	85,227	—	85,227	3,021	88,248
Investment in a subsidiary	—	—	—	—	—	—	—	—	780	780
Transfer from retained profits to statutory funds	—	—	7,926	3,963	(11,889)	—	—	—	—	—
Interim 2005 dividend	—	—	—	—	(12,982)	(12,982)	—	(12,982)	—	(12,982)
Proposed final 2005 divdend	—	—	—	—	(11,016)	(11,016)	11,016	—	—	—
At 31 December 2005	64,800	177,712	23,965	11,982	120,700	334,359	11,016	410,175	4,891	415,066

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

Notes to the Financial Statements

Year ended 31 December 2005

1.1 Basis of Preparation

These financial statements have been prepared in accordance with Hong Kong Financial Reporting Standards ("**HKFRSs**") (which also include Hong Kong Accounting Standards ("**HKASs**") and Interpretations) issued by the Hong Kong Institute of Certified Public Accountants, accounting principles generally accepted in Hong Kong and the disclosure requirements of the Hong Kong Companies Ordinance. They have been prepared under the historical cost convention, except for the remeasurement of certain equity investments as further explained below. These financial statements are presented in Renminbi ("**RMB**") and all values are rounded to the nearest thousand except when otherwise indicated.

Basis of Consolidation

The consolidated financial statements include the financial statements of the Company and its subsidiaries for the year ended 31 December 2005. The results of subsidiaries are consolidated from the date of acquisition, being the date on which the Group obtains control, and continue to be consolidated until the date that such control ceases. All significant intercompany transactions and balances within the Group are eliminated on consolidation.

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

1.2 Impact of New and Revised Hong Kong Financial Reporting Standards

The following new and revised HKFRSs affect the Group and are adopted for the first time in the current year's financial statements:

HKAS 1	Presentation of Financial Statements
HKAS 2	Inventories
HKAS 7	Cash Flow Statements
HKAS 8	Accounting Policies, Changes in Accounting Estimates and Errors
HKAS 10	Events after the Balance Sheet Date
HKAS 12	Income Taxes
HKAS 14	Segment Reporting
HKAS 16	Property, Plant and Equipment
HKAS 17	Leases
HKAS 18	Revenue
HKAS 19	Employee Benefits
HKAS 20	Accounting for Government Grants and Disclosure of Government Assistance
HKAS 21	The Effects of Changes in Foreign Exchange Rates
HKAS 23	Borrowing Costs
HKAS 24	Related Party Disclosures
HKAS 27	Consolidated and Separate Financial Statements
HKAS 32	Financial Instruments: Disclosure and Presentation
HKAS 33	Earnings per Share
HKAS 36	Impairment of Assets
HKAS 37	Provisions, Contingent Liabilities and Contingent Assets
HKAS 38	Intangible Assets
HKAS 39	Financial Instruments: Recognition and Measurement
HKAS 39 Amendment	Transition and Initial Recognition of Financial Assets and Financial Liabilities
HKAS 40	Investment Property

The adoption of HKASs 2, 7, 8, 10, 12, 14, 16, 18, 19, 20, 21, 23, 27, 32, 33, 36, 37, 38, 39 and 40 has had no material impact on the accounting policies of the Group and the Company and the methods of computation in the Group's and the Company's financial statements.

1.2 Impact of New and Revised Hong Kong Financial Reporting Standards *(continued)*

HKAS 1 has affected the presentation of minority interests on the face of the consolidated balance sheet, consolidated income statement, consolidated statement of changes in equity and other disclosures.

HKAS 24 has expanded the definition of related parties and affected the Group's related party disclosures.

The impact of adopting the other HKFR is summarised as follows:

HKAS 17 - Leases

In prior years, leasehold land and buildings held for own use were stated at cost less accumulated depreciation and any impairment losses.

Upon the adoption of HKAS 17, the Group's leasehold interest in land and buildings is separated into leasehold land and leasehold buildings. The Group's leasehold land is classified as an operating lease, because the title of the land is not expected to pass to the Group by the end of the lease term, and is reclassified from property, plant and equipment to prepaid land lease payments, while leasehold buildings continue to be classified as part of property, plant and equipment. Prepaid land premiums for land lease payments under operating leases are initially stated at cost and subsequently amortised on the straight-line basis over the lease term. When the lease payments cannot be allocated reliably between the land and buildings elements, the entire lease payments are included in the cost of the land and buildings as a finance lease in property, plant and equipment.

This change in accounting policy has had no effect on the consolidated income statement and retained profits. The comparative amounts in the consolidated balance sheet for the year ended 31 December 2004 have been restated to reflect the reclassification of the leasehold land.

1.3 Impact of Issued But Not Yet Effective Hong Kong Financial Reporting Standards

The Group has not applied the following new and revised HKFRSs, that have been issued but are not yet effective, to these financial statements. Unless otherwise stated, these HKFRSs are effective for annual periods beginning on or after 1 January 2006:

HKAS 1 Amendment	Capital Disclosures
HKAS 39 Amendment	Cash Flow Hedge Accounting of Forecast Intragroup Transactions
HKAS 39 Amendment	The Fair Value Option
HKAS 39 & HKFRS 4 Amendments	Financial Guarantee Contracts
HKFRS 7	Financial Instruments: Disclosures
HK(IFRIC)-Int 4	Determining whether an Arrangement contains a Lease

The HKAS 1 Amendment shall be applied for annual periods beginning on or after 1 January 2007. The revised standard will affect the disclosures about qualitative information about the Group's objective, policies and processes for managing capital; quantitative data about what the Company regards as capital; and compliance with any capital requirements and the consequences of any non-compliance.

HKFRS 7 will replace HKAS 32 and has modified the disclosure requirements of HKAS 32 relating to financial instruments. This HKFRS shall be applied for annual period beginning on or after 1 January 2007.

Except as stated above, the Group expects that the adoption of the other pronouncements listed above will not have any significant impact on the Group's financial statements in the period of initial application.

1.4 Summary of the Impact of Changes in Accounting Policies

Effect on the consolidated balance sheet

At 1 January 2005	**HKAS 17**
Effect of new policies (Increase/(decrease))	**Prepaid land lease payments** RMB'000
Assets	
Property, plant and equipment	(9,128)
Prepaid land lease payments	8,872
Prepayments, deposits and other receivables	256
	—

At 31 December 2005	**HKAS 17**
Effect of new policies (Increase/(decrease))	**Prepaid land lease payments** RMB'000
Assets	
Property, plant and equipment	(20,690)
Prepaid land lease payments	20,201
Prepayments, deposits and other receivables	489
	—

2. Segment Information

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

In determining the Group's geographical segments, revenues are attributed to the segments based on the locations of the customers, and assets are attributed to the segments based on the locations of the assets.

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

2. **Segment Information** *(continued)*

The following table presents revenue, profit and certain asset, liability and expenditure information for the Group's geographical segments for the year ended 31 December 2005 and 2004:

	The PRC		United States		Europe		Unallocated		Consolidated	
	2005	2004	**2005**	2004	**2005**	2004	**2005**	2004	**2005**	2004
	RMB'000	RMB'000	**RMB'000**	RMB'000	**RMB'000**	RMB'000	**RMB'000**	RMB'000	**RMB'000**	RMB'000
Segment revenue:										
Sales to external customers	**560,992**	398,351	**101,284**	52,052	**69,497**	28,347	**44,749**	8,938	**776,522**	487,688
Other revenue	**8,258**	1,768	**—**	—	**—**	—	**—**	—	**8,258**	1,768
Total revenue from continuing operation	**569,250**	400,119	**101,284**	52,052	**69,497**	28,347	**44,749**	8,938	**784,780**	489,456
Segment results	**118,901**	96,204	**8,374**	11,536	**27,736**	—	**8,803**	4,907	**163,814**	112,647
Unallocated income (a)									**5,888**	13,690
Unallocated expenses (a)									**(50,739)**	(56,189)
Finance costs									**(3,444)**	(4,572)
Profit before tax									**115,519**	65,576
Tax									**(27,271)**	(1,485)
Profit for the year									**88,248**	64,091
Segment assets and liabilities:										
Segment assets	**858,972**	448,916	**82,112**	17,269	**5,994**	—	**12,051**	874	**959,129**	467,059
Total assets									**959,129**	467,059
Segment liabilities	**534,064**	210,416	**9,976**	—	**—**	—	**23**	9,999	**544,063**	220,415
Total liabilities									**544,063**	220,415
Other segment information:										
Depreciation and amortisation	**13,697**	9,177	**—**	—	**—**	—	**—**	—	**13,697**	9,177
Capital expenditure	**223,018**	55,772	**—**	—	**—**	—	**—**	—	**223,018**	55,772
Provision/(reversal of provision) against obsolete inventories	**4,499**	(150)	**—**	—	**—**	—	**—**	—	**4,499**	(150)
Provision for doubtful debts	**3,714**	2,171	**—**	—	**—**	—	**—**	—	**3,714**	2,171

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

3. Revenue, Other Income and Gain

Revenue, which is also the Group's turnover, represents the net invoiced value of goods sold, after allowances for returns and trade discounts during the year. All significant intra-group transactions have been eliminated on consolidation.

An analysis of revenue, other income and gain is as follows:

	Notes	**2005**	2004
		RMB'000	RMB'000
			(Restated)
Revenue			
Sale of petroleum machinery		**776,522**	487,688
Other income			
Subcontract income		**342**	446
Investment income from a trust investment		**—**	289
Bank interest income	5	**2,048**	1,029
Government subsidies	(i)	**710**	3,019
VAT refund	(ii)	**2,165**	9,168
Rental income	5	**153**	98
Sale of raw materials	(iii)	**7,559**	1,122
Others		**965**	185
		13,942	15,356
Gain			
Gain on disposal of property, plant and equipment	5	**204**	102
		14,146	15,458

Notes:

(i) Government subsidies for the year ended 31 December 2005 represented export subsidy and product innovation subsidy, which amounted to RMB160,400 and RMB550,000 respectively. Government subsidies for the year ended 31 December 2004 mainly consisted of export subsidy, new product development subsidy, enterprise technology subsidy and bonus for being successfully listed on the Growth Enterprise Market (the "**GEM**") of The Stock Exchange of Hong Kong Limited (the "**Stock Exchange**").

(ii) VAT refund for the year ended 31 December 2005 represented VAT received by Weifang Molong Drilling Equipment Company Limited（濰坊墨龍鑽採設備有限公司）("**Molong Drilling Equipment**"), which were approved by the Ministry of Civil Affairs of Shandong Province（山東省民政廳） as a welfare enterprise (民政福利企業). According to the tax document Guo Shui Fa [1994] No.155, "Notice about the levy of turnover tax of welfare enterprises issued by the State Tax Bureau（國家税務局關於民政福利企業徵收流轉税問題的通知）, the output VAT paid by Molong Drilling Equipment is refundable.

(iii) Sale of raw materials for the year ended 31 December 2005 represented sale of scrap and used metals to related parties and third parties. The price is at the fixed rate prescribed by the relevant authorities of the PRC. If no fixed price is prescribed by the relevant authorities of the PRC, the sales price will be negotiated and agreed by both parties with reference to the then prevailing market price.

4. Finance Costs

	Group	
	2005	2004
	RMB'000	RMB'000
Interest on bank borrowings wholly repayable within five years	**3,444**	4,572

5. Profit before Tax

The Group's profit before tax is arrived at after charging/(crediting):

		Group	
	Notes	**2005**	2004
		RMB'000	RMB'000
			(Restated)
Cost of inventories sold		**596,113**	391,030
Depreciation		**13,382**	9,056
Amortisation of know-how		**39**	8
Recognition of prepaid land lease payment		**276**	113
Research and development costs:			
Current year expenditure		**5,724**	3,983
Minimum lease payments under operating leases:			
Plant and machinery		**108**	—
Land and buildings located in the PRC		**434**	267
		542	267
Auditors' remuneration		**1,000**	600
Employee benefits expense (including directors' remuneration:			
Wages and salaries		**24,403**	16,675
Pension scheme contributions		**5,015**	1,765
		29,418	18,440
Foreign exchange differences, net		**1,314**	86
Provision for bad and doubtful debts		**3,714**	2,171
Rental income	3	**(153)**	(98)
Bank interest income	3	**(2,048)**	(1,029)
Gain on disposal of items of property, plant and equipment	3	**(204)**	(102)

6. **Tax**

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

Molong Drilling Equipment, the Company's subsidiary, was approved by the Ministry of Civil Affairs of Shandong Province（山東省民政廳）as a welfare enterprise（民政福利企業）and hence was entitled to a full exemption from corporate income tax for years 2004 and 2005 respectively according to the tax document Cai Shui Zi [1994] No.1 *Notice about the several preferential policies on corporate income tax*（關於企業所得稅若干優惠政策的通知）.

The Company's previous subsidiary, Shouguang Molong Machinery Company Limited ("Molong Machinery"), which has voluntarily liquidated in November 2004, was approved by the Ministry of Civil Affairs of Shandong Province（山東省民政廳）as a welfare enterprise（民政福利企業）and hence was entitled to a full exemption from corporate income tax throughout its operation period in the year 2004 until its liquidation date, according to the tax document Cai Shui Zi [1994] No.1*Notice about the several preferential policies on corporate income tax*（關於企業所得稅若干優惠政策的通知）.

	Group	
	2005	2004
	RMB'000	RMB'000
PRC tax charge for the year	**32,509**	12,818
Tax exemption granted for prior year	**—**	(11,333)
Deferred	**(5,238)**	—
Total tax charge for the year	**27,271**	1,485

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

	2005		**2004**	
	RMB'000	%	RMB'000	%
Profit before tax	**115,519**		65,576	
Tax at the statutory tax rate	**38,122**	**33.00**	21,640	33.00
Additional research and development expenses deductible due to increase in research and development expenses in current year by more than 10%	**(944)**	**(0.82)**	(539)	(0.82)
Expenses not deductible for tax	**114**	**0.10**	37	0.06
Tax exemption granted to a welfare enterprise for prior year	**—**	**—**	(11,333)	(17.28)
Tax exemption granted to a welfare enterprise for the year	**(10,021)**	**(8.67)**	(1,617)	(2.47)
Adjustments in respect of current tax of previous period	**—**	**—**	(680)	(1.04)
Tax exemption of purchased fixed assets used for qualified technological improvement projects	**—**	**—**	(6,023)	(9.18)
Tax charge at the Group's effective tax rate	**27,271**	**23.61**	1,485	2.27

7. **Net Profit from Ordinary Activities Attributable to Equity Holders of the parent**

The net profit from ordinary activities attributable to equity holders of the parent for the year ended 31 December 2005 dealt with in the financial statements of the Company, was RMB58,039,000 (2004: RMB114,706,000).

8. **Dividends**

	2005	2004
	RMB'000	RMB'000
Interim — RMB0.02 (2004: RMB0.02) per ordinary share	**12,982**	10,806
Proposed final — RMB0.017 (2004: RMB0.015) per ordinary share	**11,016**	8,100
	23,998	18,906

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

9. **Earnings Per Share Attributable to Ordinary Equity Holders of the Parent**

The calculation of basic earnings per share amounts is based on the net profit for the year attributable to ordinary equity holders of the parent of RMB85,227,000 (2004: RMB61,366,000), and the weighted average number of ordinary shares in issue during the year which is 604,798,000 (2004: 501,261,934), as adjusted to reflect the issue of shares during the year.

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

10. **Reserves**

The amounts of the Group's reserves and the movements therein for the current and prior year are presented in the consolidated statement of changes in equity on page 5 of the financial statements.

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

MANAGEMENT DISCUSSION AND ANALYSIS

Business Review

The successful listing of the Company on the GEM of the Stock Exchange on 15 April 2004 opened up a new era of business development. As at 12 May 2005, the Company embarked on another capital initiative to raise fund by placing additional 108,000,000 H shares. With proceeds from the additional issue, the Group was able to further enhance its core competitiveness and capture its edge in both the development and industrial expansion in the petroleum exploitation machinery industry.

In 2005, the Group's productivity improved significantly. The production targets set out in the prospectus of the Company dated 30 March 2004 (the "**Prospectus**") have all been reached or surpassed. The oil casing production line with an annual capacity of 250,000 tons is being implemented and fine-tuned, with trial production expected in April 2006.

In terms of market exploration, currently, the Group's customers are mainly oil fields of the subsidiaries and branches of PetroChina Company Limited (collectively "**PetroChina Group**" **)** and China Petroleum & Chemical Corporation (collectively "**Sinopec Group**"), including Daqing Oil Field (大慶油田), Shengli Oil Field (勝利油田), Xinjiang Oil Field (新疆油田), Zhongyuan Oil Field (中原油田) and Liaohe Oil Field (遼河油田). Apart from its continued efforts in consolidating relationships with the existing customers and securing new ones, the Group has also been placing great emphasis on exploring new overseas markets. At present, the Group has built up solid export businesses to regions such as North America, Europe, Russia and South East Asia. The Group has established and maintained close cooperation with various international petroleum service corporations in connection with the sales of its products in the overseas markets. During the Relevant Period, revenue from exports of the Group increased significantly to 27.8% of its sales income, laying a solid foundation for the Group's future development in the overseas markets.

During the Relevant Period, the Enterprise Resources Planning ("**ERP**") system implemented by the Group has facilitated internal communications and improved the resources deployment efficiency and management quality. The system also provided the latest market and product information for its international and domestic customers.

The Company has strived for the advancement in corporate management standard. During the Relevant Period, the Company has appointed a professional consulting company on the implementation of a standardized management enhancement project. Upon the implementation, the aim of this project is to boost the quality of internal management of the Company, enhancing the corporate management standard of the Company.

The management considers that quality of raw materials is vital in ensuring the high quality of the Group's products. During the Relevant Period, the Group has entered into an "Oil Well Pipe and Casing Billets Supply Agreement" with Weihai Baolong Special Petroleum Materials Company Limited to secure sufficient and stable supply of raw materials.

During the Relevant Period, the Group has obtained a number of accreditations from the PRC government, banks, and taxation departments, including "Top 100 Sales Income Enterprises in Shandong Province", "Information Enterprise Model in Manufacturing Industry of Shandong Province", "Top 50 Enterprises of Weifang City in 2005", "Shouguang City Extra Large Enterprise", "Class A Tax Paying and Good Credit Entity", "AAA Good Credit Enterprise", and "Top 100 China's Potential Companies in Forbes".

Prospects

The rapid growth of the economy in the PRC has further boosted the market demand for crude oil. It is expected that demand on oil will remain growing rapidly in the coming years, creating a growth environment for the petroleum exploitation machinery manufacturing industry.

According to authoritative statistics, the PRC is currently the world's second largest crude oil consuming country. The PRC Government attaches great emphasis to petroleum resources and is going to promulgate preferential policies to promote the development of petroleum-related sectors. The Directors are of the view that the policies will be the driving force for the rapid growth of the domestic petroleum exploitation machinery and related accessories industry, bringing unlimited business opportunities to the Group.

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

The Company has decided to transfer from the GEM Board to the Main Board of the Stock Exchange. It is believed that such move will reinforce the Company's presence in the international capital market and attract more professional investors, ultimately enhancing its financing capability. This will also elevate the Company's image in the international and domestic petroleum exploitation machinery markets, thereby opening up more opportunities for the Company to explore new markets and secure international cooperation for its stable development.

Financial Review

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

Revenue

For the Relevant Period, the Group's revenue increased significantly as a result of increasing market demand in petroleum exploitation machinery industry. The Group's revenue was approximately RMB487.7 million for the year ended 31 December 2004 and surged to approximately RMB776.5 million for the Relevant Period, representing an increase of approximately 59.2% which was principally derived from the sale of oil well pipes, oil well sucker rods, oil well pumps, casing, oil well pumping machines, petroleum exploitation machinery, and accessories.

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

Gross Profit

The Group's gross profit increased from approximately RMB96.7 million for the year ended 31 December 2004 to approximately RMB180.4 million for the Relevant Period, representing an increase of approximately 86.6%. The substantial growth was mainly due to the rapid increase in revenue and gross profit rate.

Consolidated Gross Profit Margin

The consolidated gross profit margin of the Group increased from approximately 19.8% for the year ended 31 December 2004 to approximately 23.2% for the Relevant Period, representing an increase of approximately 17.1%. The main reason for the increase in the consolidated gross profit margin was the gross profit margin of oil well pipes increased from 15.2% for 2004 to approximately 23.5% for 2005. The reason of the increase of the gross profit margin of oil well pipes is the substantial increase of self-supply rate of the seamless pipe.

Net Profit from Ordinary Activities Attributable to Shareholders

The Group's net profit from ordinary activities attributable to Shareholders increased from approximately RMB61.4 million for the year ended 31 December 2004 to approximately RMB85.2 million for the Relevant Period, representing an increase of approximately 38.9%. The substantial increase was mainly due to the rapid increase in revenue and gross profit of the Group.

Cost of Sales & Selling and Distribution Costs

The Group's cost of sales increased from approximately RMB391.0 million for the year ended 31 December 2004 to approximately RMB596.1 million for the Relevant Period, representing an increase of approximately 52.4%. The significant increase in cost of sales was mainly attributable to the growth of the Group's revenue.

The distribution cost rose from RMB20.1 million for the year ended 31 December 2004 to RMB24.9 million for the Relevant Period. The increase of distribution cost is mainly due to the increase of the Group's transportation costs by approximately RMB3.4 million in the Relevant Period.

Administrative Expenses

The Group's administrative expenses increased from approximately RMB14.3 million for the year ended 31 December 2004 to approximately RMB33.2 million for the Relevant Period, representing an increase of approximately 131.9%. The increase in administrative expenses was mainly attributable to the increase of number of employees, the cost of emoluments and staff benefits by approximately RMB7.0 million for the Relevant Period.

Finance Costs

The finance costs of the Group for the Relevant Period was approximately RMB3.4 million, representing approximately 0.4% of the Group's total revenue and a decrease of approximately RMB1.1 million over Relevant Period. The decrease in finance costs was principally due to the Group's enhancement of capital control.

Research and Development Costs

The research and development costs of the Group for the Relevant Period was approximately RMB5.7 million, representing approximately 0.7% of the Group's total revenue and a increase of approximately RMB1.7 million over Relevant Period.

Liquidity and Financial Resources

The Group generally financed its operations and investment activities by internal financial resources and banking facilities. As at the end of the Relevant Period, the Group had outstanding bank loans of approximately RMB50.0 million.

As at the year ended 31 December 2005, the Group had a net cash and bank balances of approximately RMB110.2 million (2004: approximately RMB26.1 million) and pledged time deposits of approximately RMB147.6 million (2004: approximately RMB61.9 million). Net current assets of the Group was approximately RMB55.2 million (2004: approximately RMB113.3 million). The Directors consider that the Group has sufficient financial resources to meet its liabilities and commitments.

Gearing Ratio

The Group's gearing ratio was approximately 56.7% (2004: 47.2%) which is calculated based on the Group's total liabilities of approximately RMB544.1 million (2004: approximately RMB220.4 million) and total assets of approximately RMB959.1 million (2004: approximately RMB467.1 million).

Pledge of Assets

For the Relevant Period, no assets of the Group and the Company were pledged.

Contingent Liabilities

For the Relevant Period, the Group did not have any contingent liabilities (2004: Nil).

Banking Facilities

For the Relevant Period, the Group had bank credit loans amounting to RMB50.0 million. In addition, five banks, including the Agricultural Bank of China has granted credit facilities to the Group amounting to RMB363.0 million that have not been utilised.

Foreign Exchange Exposure

For Relevant Period, approximately 27.8% of the Group's operating revenue is denominated in US dollars and the rest are denominated in RMB. The major cost of sales and capital of the Group are mainly denominated in RMB. The Directors consider that the official exchange rate between US dollars and RMB may be stable in recent years. The Group's exposure to fluctuation in foreign exchange rate was minimal and, accordingly, the Group did not employ any financial instruments for hedging purposes.

Segment Information

An analysis of the Group's revenue and segment results by geographical segment for the Relevant Period is set out in note 2 to the financial statements.

Capital Commitment

For the Relevant Period, the Group had contracted capital commitments of approximately RMB146.3 million (2004: approximately RMB128.0 million) in respect of fixed assets.

Employees

For the Relevant Period, the Group had a total of 1,665 employees (31 December 2004: 1,308). During the Relevant Period, staff costs including directors' remuneration were approximately RMB29.4 million (2004: RMB18.4 million). The Group's employment and remuneration policies remain unchanged from those described in the Prospectus. The salaries and benefits of employees of the Group are kept at a competitive level and employees are rewarded on a performance related basis within the general framework of the Group's salary and bonus system which is reviewed annually. A wide range of benefits are also provided to the employees by the Group.

For the Relevant Period, the breakdown of the number of employees of the Group was set out below:

	As at 31 December	
	2005	2004
Research and development	**56**	47
Production	**1,290**	975
Quality control	**93**	78
Sales and marketing	**58**	52
Administration	**168**	156
Total	**1,665**	1,308

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

Significant Investments

The Group did not hold any significant investments during the Relevant Period.

Dividends

The Board has resolved to recommend a final dividend of approximately RMB0.017 per share (inclusive of tax) for the Relevant Period. The proposal to declare and pay this final dividend will be submitted to the annual general meeting to be held on 12 May 2006. Final dividend for domestic shares of the Company will be declared and paid in RMB whereas dividend for H shares of the Company will be declared in RMB and paid in Hong Kong dollars on or about 14 July 2006. The H share register of the Company will be closed from 12 April 2006 to 12 May 2006 (both days inclusive) during which no transfer of H shares of the Company will be registered.

There was no arrangement under which the Shareholders waived or agreed to waive any dividends during the Relevant Period.

Acquisitions and Disposals during the Year and Future Investment Plans

The Group did not have any acquisitions and disposals during the Relevant Period. Currently, the Company and the Group do not have significant investment plan.

Comparison of Business Objective 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. For the Relevant Period, the Group has utilised the proceeds as follows:

	Proposed use of proceeds as at 31 December 2005 as stated in the Prospectus	Actual amount used as at 31 December 2005	Remaining proceeds as at 31 December 2005
	HK$ million	HK$ million	HK$ million
Research and development	**5.70**	**5.70**	**0.70**
Expansion of production capacity	**36.50**	**37.30**	**—**
Production improvement and development	**22.90**	**22.90**	**0.40**
Sales and marketing	**1.55**	**1.55**	**0.40**
Human resources	**1.10**	**1.10**	**0.40**
Certification	**0.30**	**0.25**	**0.25**
Total	**68.05**	**68.80**	**2.15**

As the demand on petroleum exploitation machinery market is rising, the Group has speeded up in expanding production capacity, and complete some of the objectives set out in the prospectus ahead of time.

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

Business objectives 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 research and development on petroleum extraction machinery and related accessories	The planned research and development has been achieved

Business objectives as stated in Prospectus	*Actual business progress*
Expansion of production capacity	
To achieve annual production capacity of oil well pumps to approximately 10,000 units	The planned annual production capacity has been achieved
To achieve annual production capacity of oil well sucker rods to approximately 3,000,000 meters	The annual production capacity of oil well sucker rods has been increased to approximately 3,500,000 meters
To achieve annual production capacity of oil well pumping machines to approximately 200 units	The planned annual production capacity has been achieved
To 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 and achieve the planned annual production capacity of approximately 60,000 tons
To achieve annual production capacity of oil well pipes to approximately 45,000 tons	The planned annual production capacity of oil well pipes has been increased to approximately 60,000 tons

Business objectives as stated in Prospectus	*Actual business progress*
Production improvement and development	
To develop oil well pipes which can withstand high pressure	Successfully developed oil well pipes which can withstand high pressure
To develop advanced and reliable oil well sucker rods by utilising high quality steel raw materials and to construct the production facilities for oil well sucker rods	The development of advanced and reliable oil well suck rods and the construction of relevant production facilities completed
To enhance oil well pumps performance under specific oil well conditions, such as anti-corrosion, sand-proof, etc.	The objective has been achieved
To enhance system operations for oil well pumping machines	The objective has been achieved
Improve and develop products in response to market demands and changes	Successfully developed several types of products, such as oil well sucker rods
Sales and marketing	
To refine and increase the speed for the Group's official website and to further understand domestic and foreign market of petroleum machinery	The Group's official website has been revamped and its speed has also been increased
To reinforce current sales network (domestic and foreign) and simultaneously to further explore markets in North America and the Middle East by sending sales principals to North America and the Middle East	Sales principals have been sent to North America and the Middle East, sales agents were appointed and business relationships with certain clients have been established
Human resources	
To expand the Group's work force by recruiting high caliber individuals from time to time	The objective, including the recruitment of suitable personnel responsible for research & development, production, quality control, sales & marketing & administration, has been achieved

Business objectives as stated in Prospectus	*Actual business progress*
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 rights to use API Monogram for oil well pumps, oil well sucker rods and oil well pipes; to apply for the right to use API Monogram for oil well pumping machines	The renewal of the rights to use API Monogram for oil well pumps, oil well sucker rods and oil well pipes have been completed. The application for the right to use API Monogram for oil well pumping machines has been delayed
To apply the right to use API Monogram for new innovated Petroleum Machinery	The new innovated Petroleum Machinery do not have to reapply the right to use API Monogram

The net proceeds from placing of H shares by the Company on 12 May 2005, amounted to approximately HK$94.80 million. As at Relevant Period, the Group has utilized the proceeds as follows:

	Proposed use of proceeds from placing HK$ million	**Actual amount used as by 31 December 2005** HK$ million	**Remaining proceeds as at 31 December 2005** HK$ million
Purchased production line of oil casing and relevant parts	**94.80**	**94.80**	**0.00**

Comparisons of the business objectives set out in the placing announcement with the actual business progress for the period from 12 May 2005 to the Relevant Period are as follows:

Business objectives as stated in the placing announcement	*Actual business progress*
Purchased production line of oil casing and relevant parts	All facilities for production lines have been received and are under testing and setting up

Disclosure of Directors', Supervisors' and Chief Executive's Interests in Shares, Underlying Shares and Debentures

As at 31 December 2005 interests and short positions of the Directors, Supervisors and chief executives of the Company in the shares, underlying shares or debentures of the Company or any of its associated corporations (within the meaning of Part XV of the Securities and Futures Ordinance (the "SFO")), which will be required to be notified to the Company and the Stock Exchange pursuant to Divisions 7 and 8 of Part XV of the SFO (including interests or short positions which they are taken or deemed to have under such provisions of the SFO) or which will be required, pursuant to section 352 of the SFO, to be entered in the register referred to therein, or which will be required pursuant to Rules 5.46 to 5.68 of the GEM Listing Rules, to be notified to the Company and to the Stock Exchange, will be as follows:

Long positions in shares of the Company

Name	**Type of interest**	**Number of domestic shares** (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 are domestic shares)

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

Substantial Shareholders

As at 31 December 2005, so far as the Directors are aware, the following persons (other than Directors or chief executives) 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	76,760,000	—	31.17%	11.85%
RAB Energy Fund Limited (Note 5)	Investment manager	33,832,000	—	13.74%	5.22%
Cheah Cheng Hye (Note 5)	Corporate interests controlled by the significant shareholder	19,076,000	—	7.75%	2.94%
Value Partners Limited (Note 5)	Investment manager	19,076,000	—	7.75%	2.94%
Commonwealth Bank of Australia (Note 5)	Corporate interest controlled by the significant shareholder	15,298,000	—	6.21%	2.36%

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

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

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

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

Note 5: Interests in H shares.

Save as disclosed above, so far as the Directors are aware, there are no other persons not being a Director or chief 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.

Code on Corporate Governance Practices

The Company is committed to the establishment of good corporate governance practices and procedures. The corporate governance principles of the Company emphasise a quality board, sound internal control, and transparency and accountability to all shareholders. The Company has applied the principles and complied with all code provisions and, where applicable, the recommended best practices of the Code on Corporate Governance Practices as set out in Appendix 15 of the GEM Listing Rules ("**Code on CG Practices**") throughout the year ended 31 December 2005.

Competing Interests

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

Compliance Adviser's Interest

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

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

Audit Committee

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

The audit committee has reviewed with the management the accounting principles and practices adopted by the Group and discussed internal controls and financial reporting matters, including a review of the audited results of the Group for the year ended 31 December 2005.

Purchase, Sale or Redemption of Securities

Neither the Company nor its subsidiaries has purchased, sold or redeemed any listed securities of the Company during the Relevant Period.

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

Shandong, the PRC
19 March 2006

This announcement will remain on the GEM website on the "Latest Company Announcements" page or 7 days form the day of its posting.

As at the date of this announcement, the directors of the Company are:

Executive Directors

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

Non-executive Directors

Mr. Chen Jian Xiong
Mr. Wang Ping

Independent non-executive Directors

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