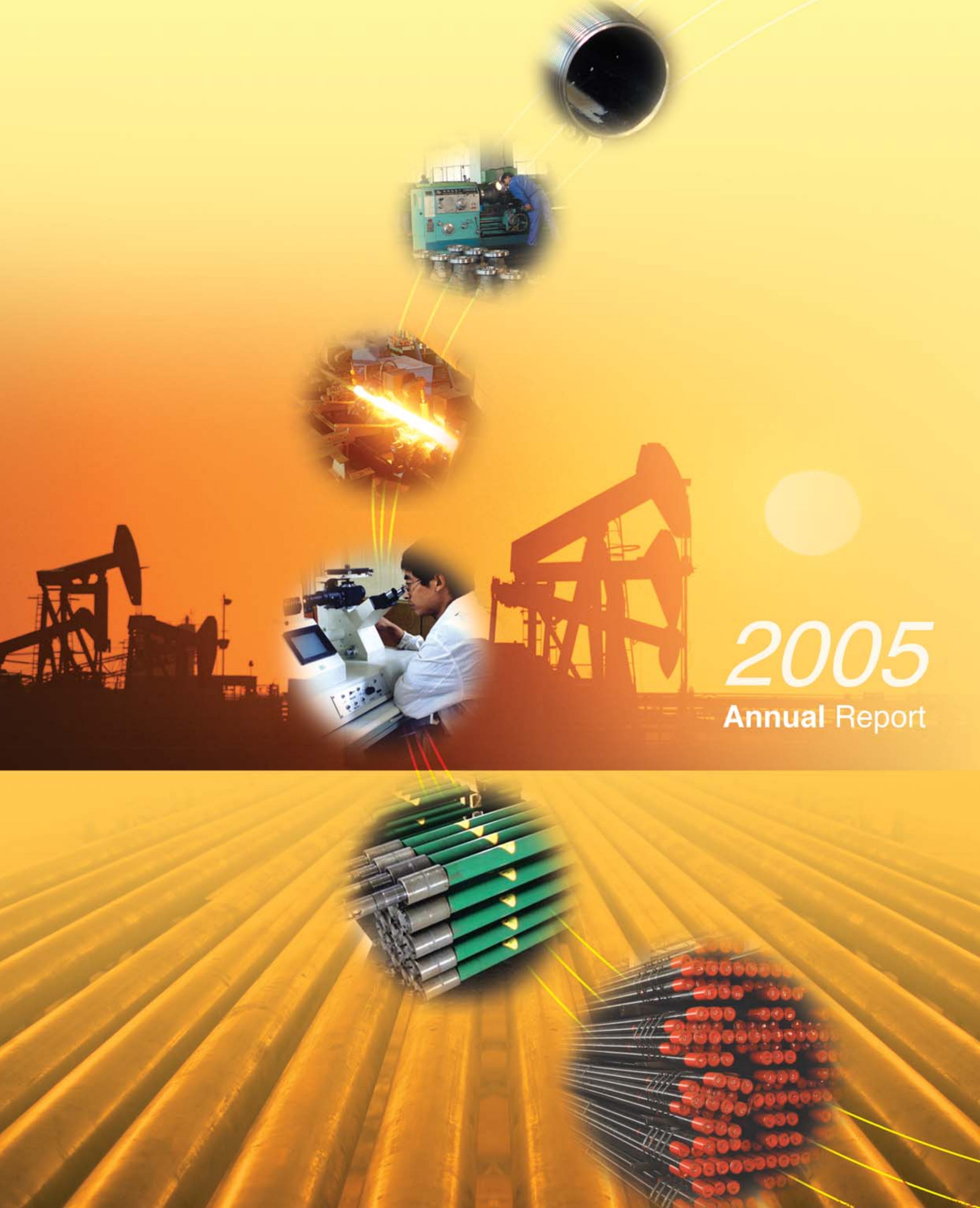
山東墨龍石油機械股份有限公司

Shandong Molong Petroleum Machinery Company Limited

(a Sino-foreign joint stock limited company incorporated in the People's Republic of China with limited liability)
(Stock Code: 8261)



2005 Annual Report

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.

The Stock Exchange takes no responsibility for the contents of this report, makes no representation as to its accuracy or completeness and expressly disclaims any liability whatsoever for any loss howsoever arising from or in reliance upon the whole or any part of the contents of this report.

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

Contents

Directors

Executive Directors

Mr. Zhang En Rong *(Chairman)*
Mr. Zhang Yun San *(Deputy Chairman)*
Mr. Lin Fu Long
Mr. Xie Xin Cang

Non-executive Directors

Mr. Chen Jian Xiong
Mr. Wang Ping

Independent non-executive Directors

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

Supervisors

Ms. Li Bao Hui *(Chairman of the Supervisory Committee)*
Mr. Liu Wan Fu
Mr. Fan Ren Yi

Members of Nomination Committee

Mr. Yan Yi Zhuang *(Chairman of the Nomination Committee)*
Mr. Zhang Yun San
Mr. Qin Xue Chang
Mr. Loke Yu alias Loke Hoi Lam

Members of Remuneration and Appraisal Committee

Mr. Loke Yu alias Loke Hoi Lam *(Chairman of the Remuneration and Appraisal Committee)*
Mr. Zhang Yun San
Mr. Qin Xue Chang
Mr. Yan Yi Zhuang

Members of Audit Committee

Mr. Qin Xue Chang *(Chairman of the Audit Committee)*
Mr. Yan Yi Zhuang
Mr. Loke Yu alias Loke Hoi Lam

Qualified Accountant

Mr. Chan Wing Nang, Billy

Company Secretary

Mr. Chan Wing Nang, Billy

Compliance Officer

Mr. Xie Xin Cang

Authorised Representatives

Mr. Xie Xin Cang
Mr. Chan Wing Nang, Billy

Authorised Person to Accept Service of Process and Notices

Mr. Chan Wing Nang, Billy

Auditors

Ernst & Young

Compliance Adviser

Deloitte & Touche Corporate Finance Limited

Legal Advisers

Coudert Brothers in association with Orrick, Herrington & Sutcliffe LLP. (As to Hong Kong Law)
Hao Tian Law Office (As to PRC Law)

Principal Bankers

Agricultural Bank of China
Bank of China
China Citic Bank
Weifang Commercial Bank
China Everbright Bank

H Share Registrar and Transfer Office in Hong Kong

Tricor Investor Services Limited
26/F., Tesbury Centre
No. 28 Queen's Road East
Hong Kong

Investor and Media Relations Consultant

Porda International (Finance) P.R. Co., Ltd.
7/F, CMA Building
No, 64 Connaught Road Central
Hong Kong
Tel: (852) 25446388
Fax: (852) 25446126

Registered Address

No. 99 Beihai Road, Shouguang City
Shandong Province, the People's Republic of China

Principal Place of Business in Hong Kong

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Ho Lee Commercial Building
38-44 D'Aguilar Street
Central
Hong Kong

Website

www.molonggroup.com

Stock Code

8261

Results

	Year ended 31 December				
	2005	2004	2003	2002	2001
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
Revenue	**776,522**	487,688	302,274	197,776	154,308
Profit from operating activities	**118,963**	70,148	64,085	28,777	14,029
Profit before tax	**115,519**	65,576	59,347	26,555	13,296
Profit for the year	**88,248**	64,091	46,150	18,632	12,312
Minority interests	**(3,021)**	(2,725)	(2,173)	466	(784)
Net profit from ordinary activities attributable to shareholders	**85,227**	61,366	43,977	19,098	11,528
Earnings per share – basic (RMB)	**0.141**	0.122	0.109	0.0472	0.0285

Assets and Liabilities

	As at 31 December				
	2005	2004	2003	2002	2001
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
Total assets	**959,129**	467,059	383,356	330,906	203,549
Total liabilities	**544,063**	220,415	264,457	192,893	126,396
Net assets (restated)	**415,066**	246,644	118,899	138,013	77,153

On behalf of the board of Directors (the "**Board**" or "**Directors**") of the Company, I am pleased to present the annual report and the audited financial statements of the Company together with its subsidiaries (collectively the "**Group**") for the financial year ended 31 December 2005 (the "**Relevant Period**") to the shareholders of the Company (the "**Shareholders**").

Outstanding Achievements for the Year

The Group recorded an encouraging business growth during the Relevant Period. For the year ended 31 December 2005, the Group's revenue was approximately RMB776.5 million, representing an increase of approximately 59.2% as compared with the previous year. Over the same period, the Group's net profit from ordinary activities attributable to Shareholders and earnings per share were approximately RMB85.2 million and RMB0.141, representing an increase of approximately 38.9% and 15.6%, respectively, as compared with the previous year. All these results clearly demonstrated the persistent effort in the growth of the Group's business.

Business Review

The successful listing of the Company on the GEM of the Stock Exchange on 15 April 2004 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.

Acknowledgement

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

Zhang En Rong
Chairman

Shandong, the PRC
19 March 2006

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 an 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 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. Details of bank loans at 31 December 2004, which were secured by certain assets of the Group, are included in note 26 to the financial statements.

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 (2004: RMB30.0 million). In addition, five banks, including the Agricultural Bank of China has granted credit facilities to the Group amounting to RMB363.0 million (2004: RMB190.0 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 4 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.

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.

The net proceeds from the placing and public offer of H shares by the Company on 15 April 2004, which amounted to approximately HK$76.35 million, was intended to be used by the Directors as stated in the Prospectus and out of which approximately HK$5.4 million was used for general working capital. As at 31 December 2005, the Group has utilised the proceeds as follows:

	Proposed use of proceeds as set out in the Prospectus up to 31 December 2005	Actual use of proceeds up to 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

Directors

Executive Directors

Mr. Zhang En Rong (張恩榮先生), aged 66, is the chairman of the Company and executive Director. Mr. Zhang is a founder of the Company and is responsible for the overall strategic planning and management and business development of the Group. Since its establishment, Mr. Zhang held various positions in the Group including general manager. Mr. Zhang was also a member of the 12th session, 13th session and 14th session of the Weifang City People's Congress of the PRC, a member of the 5th session and the 6th session of the Shandong Shouguang City Committee of the Chinese People's Political Consultative Conference. Mr. Zhang was the legal representative and factory manager of Shandong Shouguang Petroleum Machinery Parts Factory ("**Petroleum Machinery Parts Factory**"), Shandong Shouguang Petroleum Machinery Factory ("**Petroleum Machinery Factory**") and Weifang Molong Industrial Company ("**Weifang Molong**") from 1987 to 1993 and the general manager of Shandong Molong Holdings Company ("**Molong Holdings**") from 1994 to 2001. Mr. Zhang was granted the "Good Enterprise Management Personnel" certificate in 1988, the "Modern Industrial Manufacturing Producer" in 1991 and the "Wealth Attainment and Development of Shandong" medal of Shandong Province in 2004 (山東省「富民興魯」勞動獎章). Mr. Zhang is the father of Mr. Zhang Yun San, an executive Director.

Mr. Zhang Yun San (張雲三先生), aged 44, is a founder, the deputy chairman, executive Director and deputy general manager of the Company. He is responsible for assisting the chairman in overall strategic planning and management and business development of the Group. Since 1993, Mr. Zhang has held various positions in Molong Holdings and the Group, including deputy general manager and deputy chairman of the Company. Mr. Zhang graduated from Nanjing University with a bachelor of laws degree and holds an advanced certificate in Training Course of Chinese Communist Party School for Entrepreneurs and was granted the "Excellent Private Enterpriser of Weifang City" in 2004 and "Top Ten Young Entrepreneurs of Weifang City" in 2005. He has abundant experience in the development, manufacture and sales of petroleum exploitation machinery and the management of the Group. Mr. Zhang is the son of Mr. Zhang En Rong, an executive Director.

Mr. Lin Fu Long (林福龍先生), aged 53, is a founder, an executive Director and the general manager of the Company. He is responsible for the overall management of the Group. Mr. Lin was deputy factory manager of Petroleum Machinery Parts Factory, Petroleum Machinery Factory and Weifang Molong from 1989 to 1993 and was deputy general manager of Molong Holdings from 1994 to 2001. Mr. Lin was awarded as an "Capable Sales Person" by the Shouguang City People's Government in 1994.

Mr. Xie Xin Cang (謝新倉先生), aged 44, is a founder, an executive Director, the secretary to the Board and deputy general manager of the Company. Mr. Xie has served in Molong Holdings since 1995 as deputy general manager. During his employment, Mr. Xie has applied the nickel plating phosphorus alloy technology in the manufacturing of petroleum exploitation machinery and successfully invented the "MB424 steel wire teasel" that possess international advanced level. Mr. Xie graduated from Xian Jiaotong University in mechanical engineering and specialised in metal studies and heat treatment, the degree of Bachelor of Engineering. Mr. Xie was awarded the "Shandong Province Town and Village Enterprise Technology Innovation Leader" certificate by the Shandong Province Town and Village Enterprise Management Bureau in 1998. Mr. Xie is a member of the 7th Session of the Shandong Shouguang City Committee of the Chinese People's Political Consultative Conference. Mr Xie is the husband of Ms. Li Bao Hui, a supervisor ("**Supervisor**") of the Company.

Non-executive Directors

Mr. Chen Jian Xiong (陳建雄先生), aged 50, is a non-executive Director. Mr. Chen has worked for Rodless Oil Pump Company of Shengli Petroleum Administration Bureau for over 10 years. Since 1994, Mr. Chen is the managing director of Shengli Oil Field Kaiyuan Oil Exploitation Company Limited ("**Kaiyuan Oil**") and was assistant manager and then the general manager of Rodless Oil Pump Company of Shengli Petroleum Administration Bureau. Mr. Chen is the Chairman of Shengli Oil Field Kaiyuan Oil Exploitation Company Limited and Shengli Pump Industry Co., Ltd., Shengli Oilfield. Mr. Chen was appointed as a non-executive Director on 28 December 2001, and was re-appointed as a non-executive Director on 7 May 2005.

Mr. Wang Ping (王平先生), aged 50, is a non-executive Director. Mr. Wang has over 20 years of experience in metallurgy and received his doctorate degree in engineering from the University of Science and Technology Beijing. Since 2000, Mr. Wang is a professor at the University of Science and Technology of Beijing and was appointed as a non-executive Director on 29 March 2003.

Independent non-executive Directors

Mr. Qin Xue Chang (秦學昌先生), aged 40, is an independent non-executive Director and the Chairman of the Audit Committee. Mr. Qin has over 10 years of experience in accounting and auditing industry. He received his bachelor degree in economics from Shanxi University of Finance and Economics and is a practicing certified public accountant in the PRC. Mr. Qin is a deputy chairman of Beijing Yongtuo Certified Public Accountants Co., Ltd., Director of Shandong Branch Office, Beijing Yongtuo Certified Public Accountants Co., Ltd. and was appointed as an independent non-executive Director on 29 March 2003.

Mr. Yan Yi Zhuang (閻翊莊先生), aged 48, is an independent non-executive Director and the Chairman of the Nomination Committee. He is also a deputy operation manager of Shougang Concord Technology Holdings Ltd., a company listed on the Main Board of the Stock Exchange. Mr. Yan has over 10 years of management experience in electronics technology and graduated from the University of Western Sydney, Australia. Mr. Yan was appointed as an independent non-executive Director on 29 March 2003.

Mr. Loke Yu alias Loke Hoi Lam (陸海林先生), aged 56, was appointed to the board as an independent non-executive Director and a chairman of Remuneration and Appraisal committee in the year of 2004. Mr. Loke has over 30 years of experience in accounting and auditing for private and public companies, financial consultancy and corporate management. He holds a Master of Business Administration Degree from Universiti Teknologi Malaysia and a Doctor of Business Administration Degree from University of South Australia. He is a Fellow of The Institute of Chartered Accountants in England and Wales; Hong Kong Institute of Certified Public Accountants; and The Hong Kong Institute of Directors. He is also an Associate member of The Hong Kong Institute of Chartered Secretaries and a member of Malaysian Institute of Accountants. He is Chairman of MHL Consulting Limited and serves as an independent non-executive director of United Metals Holdings Limited, New Chinese Medicine Holdings Limited, Matrix Holdings Limited, Yanion Internaional Holdings Limited and Wealthmark International (Holdings) Limited, companies listed on the Stock Exchange of Hong Kong Limited.

Supervisors

Ms. Li Bao Hui (李寶惠女士), aged 42, is a Supervisor and the chairman of the supervisory committee of the Company (the "**Supervisory Committee**"). She is currently a quality control manager of the Company and works in the quality control department of Molong Holdings since 1995. She has over 10 years of experience in quality control and quality management and graduated from Shanxi Radio and Television University. Ms. Li is the wife of Xie Xin Cang, an executive Director, and was appointed as a Supervisor on 29 March 2003.

Mr. Liu Wan Fu (劉萬賦先生), aged 67, is a Supervisor. Mr. Liu is a consultant of China National Petroleum Corporation. Mr. Liu has over 40 years of experience in the petroleum industry. Mr. Liu was appointed as a Supervisor on 29 March 2003.

Mr. Fan Ren Yi (樊仁意先生), aged 40, is a Supervisor. Mr. Fan is the Vice General Manager and CFO of Shandong Charming Home-Textiles Co., Ltd.. Mr. Fan holds a bachelor degree from Xian Jiaotong University and is a certified public accountant in the PRC. Mr. Fan was appointed as a Supervisor on 29 March 2003.

Senior Management

Mr. Zhang Yu Zhi (張玉之先生), aged 47, is a deputy general manager of the Company. He is responsible for the sales of the Group. Mr. Zhang has over 10 years of experience in petroleum exploitation machinery industry. Before joining the Group, he was responsible for management of Weifang Transportation Company and Shouguang Shangkou Sales Agency. He joined the Group in October 1994, as general manager of its Xinjiang representative office, and has participated in the petroleum exploitation machinery industry since then.

Mr. Guo Huan Ran (國煥然先生), aged 39, is the deputy general manager of the Company and is responsible for production and technology research and development of the Group. Mr. Guo joined Molong Holdings in March 1991. Mr. Guo graduated from Weifang College, major in Machine Manufacturing and Processing Equipment, and held various positions in the Company including technician, workshop supervisor and Production Director. Mr. Guo has extensive experience in areas including production management and technology research and development of petroleum exploitation machinery. Mr. Guo has directed the innovation of various items for export, such as liner for mud pump and valve body. Some of the products, such as "Special Centralizer for Electrical Submersible Pump System", gained the third prize of "Science and Technology Achievements Award from Village & Township Enterprises Administration of Ministry of Agriculture of People's Republic of China".

Mr. Cui Huan You (崔煥友先生), aged 57, is in charge of the finance of the Company. Mr. Cui has significant experience in finance, accounting and taxation. He joined Molong Holdings as an accounting supervisor in June 1995. He graduated from Shandong Province Financial Zhigong University. Mr. Cui was awarded the "Outstanding Financial Management Personnel" in 1992 and the "Advanced Accountant of Weifang City" in 2004.

Mr. Liang Yong Qiang (梁永強先生), aged 37, is the chief engineer of the Company. Mr. Liang joined Molong Holdings in July 2001. He graduated from Xian Jiaotong University, Bachelor Degree. Mr. Liang participated in the development of certain models of oil well pumps and has won a second prize in the "Shandong Province Weifang City Kuiwen District First Science and Technology Enhancement Contest".

Qualified Accountant and Company Secretary

Mr. Chan Wing Nang, Billy (陳永能先生), aged 44, is the qualified accountant and company secretary of the Company. Mr. Chan graduated from the University of Newcastle upon Tyne, United Kingdom with a bachelor degree in Civil Engineering in 1986. He also read a master degree in business administration at the University of Warwick, United Kingdom. Mr. Chan is a member of the Hong Kong Institute of Certified Public Accountants and The Institute of Chartered Accountants in England and Wales. Mr. Chan has over 10 years of experience in the accounting and consulting field. Prior to joining the Group, Mr. Chan was a director in a consulting company. Mr. Chan joined the Group on 13 December 2004.

The board of Directors has the pleasure to present the annual report and the audited financial statements for the Relevant Period.

Principal Activities

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

Results

The Group's profit for the Relevant Period and the state of financial affairs of the Company and the Group at that date are set out in the financial statements on pages 41 to 88 of the annual report.

Financial Summary

A summary of the results and of the assets and liabilities of the Group for the past five financial years is set out on page 6 of the annual report.

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.

Share Capital

The change(s) in share capital of the Company for the Relevant Period is set out in note 28 to the financial statements.

Reserves and Distributable Reserves

Details of movements in the reserves of the Group and of the Company for the Relevant Period are set out in note 29 to the financial statements.

Under the PRC laws and regulations, the Company's distributable reserves will be based on the lower of the amount calculated according to the PRC accounting principles and rules and the amount calculated according to the Hong Kong generally accepted accounting principles. At the end of the Relevant Period, the Company's distributable profit was RMB113,081,000 (2004: RMB88,013,000).

Property, Plant and Equipment, and Investment Properties

Details of movements in the property, plant and equipment and investment properties of the Group for the Relevant Period are set out in notes 14 and 15 to the financial statements.

Capitalised Interest

For the Relevant Period, the Group did not have any capitalised interest.

Directors and Supervisors

The Directors and Supervisors during the Relevant Period and up to the date of this report were:

Executive Directors

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

Non-executive Directors

Mr. Chen Jian Xiong
Mr. Wang Ping

Independent non-executive Directors

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

Supervisors

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

Directors' and Supervisors' Service Contracts or Letters of Appointment

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

Re-elected Directors

Non-executive Director

The appointment of Mr. Wang Ping, a non-executive Director, ended on 29 March 2006. Pursuant to the articles of association of the Company, he was appointed as a non-executive Director by the board of Directors until the annual general meeting of the Company to be held on 12 May 2006 ("**AGM**"). Mr. Wang Ping will offer himself for re-election as a non-executive Director at the AGM.

Mr. Wang Ping (王平先生), aged 50, is a non-executive Director. Mr. Wang has over 20 years of experience in metallurgy and received his doctorate degree in engineering from the University of Science and Technology Beijing. Since 2000, Mr. Wang is a professor at the University of Science and Technology of Beijing and was appointed as a non-executive Director on 29 March 2003.

An ordinary resolution will be put to shareholders of the Company to re-elect Mr. Wang as a non-executive Director at the annual general meeting of the Company for the Relevant Period.

Other than the directorship held in the Company, Mr. Wang does not hold any positions in the Company and its subsidiaries. Mr. Wang entered into service contract with the Company on 20 March 2004 for a term of three years. His director's emolument is zero. Save and except for the above, there is no other information which is discloseable pursuant to any of the requirement of GEM Listing Rule 17.50(2). There are no other matters that need to be brought to the attention of the shareholders of the Company in respect of the re-election of Mr. Wang.

Independent non-executive Directors

The appointment of each of Mr. Qin Xue Chang and Mr. Yan Yi Zhuang as an independent non-executive Director, would end on 29 March 2006. Pursuant to the articles of association of the Company, each of them was appointed as an independent non-executive Director by the board of Directors until the annual general meeting of the Company to be held on 12 May 2006 ("**AGM**"). Both of them will offer themselves for re-election as an independent non-executive Director at the AGM.

Mr. Qin Xue Chang (秦學昌先生), aged 40, is an independent non-executive Director and the Chairman of the Audit Committee. Mr. Qin has over 10 years of experience in accounting and auditing industry. He received his bachelor degree in economics from Shanxi University of Finance and Economics and is a practicing certified public accountant in the PRC. Mr. Qin is a deputy chairman of Beijing Yongtuo Certified Public Accountants Co., Ltd. and Director of Shandong Branch office, Beijing Yongtuo Certified Public Accountants Co., Ltd. Mr. Qin was appointed as an independent non-executive Director on 29 March 2003.

An ordinary resolution will be put to shareholders of the Company to re-elect Mr. Qin as an independent non-executive Director at the annual general meeting of the Company for the Relevant Period.

Other than the directorship held in the Company, Mr. Qin does not hold any positions in the Company and its subsidiaries. Mr. Qin entered into a letter of appointment with the Company on 20 March 2004 for a term of three years. His director's emolument is RMB30,000 per year which is based on his qualification, expertise and market conditions. Save and except for the above, there is no other information which is discloseable pursuant to any of the requirement of GEM Listing Rule 17.50(2). There are no other matters that need to be brought to the attention of the shareholders of the Company in respect of the re-election of Mr. Qin.

Mr. Yan Yi Zhuang (閆翊莊先生), aged 48, is an independent non-executive Director and the Chairman of the Nomination Committee. He is also a deputy operation manager of Shougang Concord Technology Holdings Ltd., a company listed on the Main Board of the Stock Exchange. Mr. Yan has over 10 years of experience in electronics technology and graduated from the University of Western Sydney, Australia. Mr. Yan was appointed as an independent non-executive Director on 29 March 2003.

An ordinary resolution will be put to shareholders of the Company to re-elect Mr. Yan as an independent non-executive Director at the annual general meeting of the Company for the Relevant Period.

Other than the directorship held in the Company, Mr. Yan does not hold any positions in the Company and its subsidiaries. Mr. Yan entered into a letter of appointment with the Company on 20 March 2004 for a term of three years. His director's emolument is HK$60,000 per year which is based on his qualification, expertise and market conditions. Save and except for the above, there is no other information which is discloseable pursuant to any of the requirement of GEM Listing Rule 17.50(2). There are no other matters that need to be brought to the attention of the shareholders of the Company in respect of the re-election of Mr. Yan.

Re-elected Supervisors

The appointment of Ms. Li Bao Hui, Mr. Liu Wan Fu,and Mr. Fan Ren Yi as a Supervisor, ended on 29 March 2006. Pursuant to the articles of association of the Company, they were appointed as a Supervisor by the board of Directors until the AGM to be held on 12 May 2006. Ms. Li Bao Hui, Mr. Liu Wan Fu,and Mr. Fan Ren Yi will offer themselves for re-election as a Supervisor at the AGM.

Ms. Li Bao Hui (李寶惠女士), aged 42, is a Supervisor and the chairman of the supervisory committee of the Company (the "**Supervisory Committee**"). She is currently a quality control manager of the Company and works in the quality control department of Molong Holdings since 1995. She has over 10 years of experience in quality control and quality management and graduated from Shanxi Radio and Television University. Ms. Li is the wife of Xie Xin Cang, an executive Director, and was appointed as a Supervisor on 29 March 2003.

An ordinary resolution will be put to shareholders of the Company to re-elect Ms. Li as a Supervisor at the annual general meeting of the Company for the Relevant Period.

Other than the role of Supervisor and quality control manager of the Company, Ms. Li does not hold any positions in the Company and its subsidiaries. Save and except as the wife of Mr. Xie Xin Cang, Ms. Li does not have relationship with any other Directors, Supervisors, senior management, substantial shareholders, management shareholders or controlling shareholders of the Company. Ms. Li is taken to be interested in the 21,410,000 domestic shares of the Company held by Mr. Xie Xin Cang under the Securities and Futures Ordinance. Ms. Li entered into a service contract with the Company on 20 March 2004 for a term of three years. Her supervisor's emolument is RMB70,000 per year which is based on her qualification, expertise and market conditions. Save and except for the above, there is no other information which is discloseable pursuant to any of the requirement of GEM Listing Rule 17.50(2). There are no other matters that need to be brought to the attention of the shareholders of the Company in respect of the re-election of Ms. Li.

Mr. Liu Wan Fu (劉萬賦先生), aged 67, is a Supervisor. Mr. Liu is a consultant of China National Petroleum Corporation. Mr. Liu has over 40 years of experience in the petroleum industry. Mr. Liu was appointed as a Supervisor on 29 March 2003.

An ordinary resolution will be put to shareholders of the Company to re-elect Mr. Liu as a Supervisor at the annual general meeting of the Company for the Relevant Period.

Other than the role of Supervisor, Mr. Liu does not hold any positions in the Company and its subsidiaries. Mr. Liu entered into a service contract with the Company on 20 March 2004 for a term of three years. His supervisor's emolument is RMB20,000 per year which is based on his qualification, expertise and market conditions. Save and except for the above, there is no other information which is discloseable pursuant to any of the requirement of GEM Listing Rule 17.50(2). There are no other matters that need to be brought to the attention of the shareholders of the Company in respect of the re-election of Mr. Liu.

Mr. Fan Ren Yi (樊仁意先生), aged 40, is a Supervisor. Mr. Fan is the Vice General Manager and CFO of Shandong Charming Home-Textiles Co., Ltd. Mr. Fan holds a bachelor degree from Xian Jiaotong University and is a certified public accountant in the PRC. Mr. Fan was appointed as a Supervisor on 29 March 2003.

An ordinary resolution will be put to shareholders of the Company to re-elect Mr. Fan as a Supervisor at the annual general meeting of the Company for the Relevant Period.

Other than the role of Supervisor, Mr. Fan does not hold any positions in the Company and its subsidiaries. Mr. Fan entered into a service contract with the Company on 20 March 2004 for a term of three years. His supervisor's emolument is RMB10,000 per year which is based on his qualification, expertise and market conditions. Save and except for the above, there is no other information which is discloseable pursuant to any of the requirement of GEM Listing Rule 17.50(2). There are no other matters that need to be brought to the attention of the shareholders of the Company in respect of the re-election of Mr. Fan.

Independent non-executive Directors

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

Emoluments of Directors and Highest Paid Individuals

Details of emoluments of Directors and highest paid individuals, which are based on their length of services, experience, qualification and/or performance, are set out in notes 8 and 9 to the financial statements.

Connected Transaction

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

On 22 September 2005, the Company and Weihai Baolong Special Petroleum Materials Co., Ltd. (威海寶隆石油專材有限公司) ("**Weihai Baolong**") entered into an oil well pipe and casing billets supply agreement. Weihai Baolong has agreed to supply the casing to the Company. The agreement has been effective from 28 November 2005 and remain in force up to 31 December 2007 (both days inclusive), It has been agreed that the supply price of oil pipe and casing billets charged by Weihai Baolong to the Company will be the prevailing market price less an agreed discount of not more than RMB100/ton. In addition, Weihai Baolong undertook that the supply price offered to the Company would not be higher than the supply price of the same goods offered to independent third parties at the same time.

On 22 September 2005, the Company and Molong Equipment, entered a machinery accessories supply agreement. Molong Equipment has agreed to supply machinery accessories to the Company. The agreement has been effective from 28 November 2005. The supply price under the agreement will be based on the prevailing market price. In addition, Molong Equipment undertook that the supply price offered to the Company would not be higher than the supply price of the same goods offered to independent third parties at the same time.

On 22 September 2005, the Company and Molong Equipment, entered a metallurgy accessories supply agreement. Molong Equipment has agreed to supply metallurgy accessories to the Company. The agreement has been effective from 28 November 2005 and remain in force up to 31 December 2007 (both days inclusive), it has been agreed that the supply price of metallurgy accessories charged by Molong Equipment to the Company will be at the fixed rates prescribed by the relevant authorities of the PRC (if any), or if no fixed rates are prescribed, with reference to the market price offered by Molong Equipment to other independent third parties less a discount. In addition, Molong Equipment undertook that the supply price offered to the Company would not be higher than the supply price of the same goods offered to independent third parties at the same time.

On 22 September 2005, the Company and Molong Equipment entered into a scrap and used metal supply agreement. The Company will supply the scrap and used metal to Molong Equipment. The agreement has been effective from 28 November 2005 and remain in force up to 31 December 2007 (both days inclusive), the price is at the fixed rate, prescribed by the relevant authorities of the PRC, or if no fixed price are prescribed with reference to the prevailing market price, subject to adjustment.

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

Maolong Machinery and Mr. Luke Fang are interested in 55.0% and 45.0% of the registered capital of Molong Equipment respectively. Mr. Fang is a third party independent of and not connected with any of the Directors, Supervisors, chief executives, substantial Shareholders, management Shareholders or its subsidiaries or any of their respective associates. Maolong Machinery and Molong Equipment are interested in 95% and 5% of the registered capital of Weihai Baolong respectively. Given that Maolong Machinery is deemed to be a connected person of the Company and that each of Molong Equipment and Weihai Baolong is a subsidiary of Maolong Machinery, each of Molong Equipment and Weihai Baolong are also deemed to be a connected person of the Company.

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

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

1. The transactions have been entered into by the Company in the ordinary and usual course of their businesses;

2. The transactions have been entered into on normal commercial terms, or where there are no sufficient comparable transactions to judge whether they are on normal commercial terms, on terms no less favourable to the Company than those available to or from independent third parties; and

3. The transactions are entered into in accordance with the terms of the agreement governing such transaction and on terms that are fair and reasonable and in the interests of the Company and shareholders of the Company as a whole.

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

1. The transactions have been approved by the Extraordinary General Meeting;

2. The transactions have been entered into in accordance with the pricing policies of the Group;

3. The transactions have been entered into in accordance with the relevant agreements governing such transaction; and

4. The transactions have not exceeded the relevant annual limits which had been agreed with The Stock Exchange of Hong Kong Limited.

Retirement/Pension Scheme Benefits

Staff welfare (salaries)	**2005 RMB'000**	2004 RMB'000
Wages and salaries	**24,403**	16,675
Contributions to retirement benefit schemes	**5,015**	1,765
Total	**29,418**	18,440

As stipulated by the laws, orders and regulations of the PRC, the Group participated in various defined contribution retirement plans organised by municipal governments for its staff. Currently, the Group is required to make contributions to the retirement plans at a rate of 16% (2004: 15.0%) of the salaries, bonuses and certain allowances of its staff of Relevant Period. A member of the plan is entitled to a pension, to be paid by the municipal governments, equal to a fixed proportion of the salary prevailing at his retirement date. The Group has no other material obligation for the payment of pension benefits associated with these plans beyond the annual contributions described above.

Disclosure of Directors', 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	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%

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.

Directors' and Supervisors' Rights to Acquire Shares or Debentures

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

Share Option Scheme

The Company does not have any share option scheme.

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%

Name	Type of interests	Number of shares	Percentage of domestic shares	Percentage of H shares	Percentage of total registered capital
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, Supervisor 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.

Directors' Interests in Contracts

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

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 (as defined under the GEM Listing Rules), employees or associates 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.

Contracts of Significance

There is no contract of significance between the Company (or any of its subsidiaries) and its controlling shareholder or any of its subsidiaries.

Major Customers and Suppliers

During the Relevant Period, the Group's products are mainly sold to domestic oilfields within the PRC. In addition, the Group also sold its products to customers in the North America, West Europe, Southeast Asia etc. and has further explored the markets in the Middle East, Africa and Latin America.

During the Relevant Period, the Group's major suppliers are reputable special steel producers in the PRC, with whom the Group has established good relationships. Oil well pipe is one of our main products, continuous casting pipe billet is the principal raw materials. The largest supplier was Dongbei Special Steel Holding Company Limited (東北特鋼集團有限公司), which the Company has signed strategic co-operation agreement with.

For the Relevant Period, the five largest customers accounted for approximately 84.5% of the Group's total revenue and the five largest suppliers of the Group accounted for approximately 49.7% of the Group's total purchases. The largest customer of the Group accounted for approximately 52.2% of the Group's total revenue, while the largest supplier accounted for approximately 21.4% of the Group's total purchases.

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

Purchase, Sale or Redemption of Securities

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

Pre-emptive Rights

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

Auditors

For the three years ended 31 December 2005, the Company did not replace auditors.

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

On behalf of the Board
Zhang En Rong
Chairman

Shandong, the PRC
19 March 2006

To the Shareholders:

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

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

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

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

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

By order of the Supervisory Committee
Li Bao Hui
Chairman of the Supervisory Committee

Shangdong, the PRC
19 March 2006

The Company strives to attain a higher standard of corporate governance. The principles of corporate governance adopted by the Group emphasize a quality board, sound internal control, and transparency and accountability to all stakeholders.

(a) Corporate Governance Practices

The Code on Corporate Governance Practices was effective for accounting periods commencing on or after 1 January 2005. The Company put strong emphasis on the superiority, steadiness and rationality of corporate governance. In order to comply with the requirement of the Code on Corporate Governance Practices, the Company has set up a committee to review its internal management structure. The Directors are of the view that the Company has complied with the requirements with respect to Appendix 15 "The Code on Corporate Governance Practices" to the Listing Rules on the Growth Enterprise Market of The Stock Exchange of Hong Kong Limited throughout the accounting period covered by the annual report.

(b) Directors' Securities Transactions

During the Relevant Period, the Company has adopted a model code regarding Directors' securities transactions on terms no less exacting than the required standard of dealings set out in Rule 5.48 to 5.67 of the GEM Listing Rules. The Company has not adopted any code of conduct regarding Directors' securities transactions which is stricter than that of "the required standard of dealings". The Company, having made specific enquiries to all Directors, is not aware that any Directors has failed to comply with the required standard of dealings and the Model Code for Securities Transactions by Directors.

(c) The Board

The Board is responsible for planning and overseeing the overall development and management of the Group with the objective of enhancing shareholders' value. The Board, led by the Chairman, is responsible for the approval and monitoring of the overall strategies and policies of the Group, approval of annual budgets and business plans, evaluation of the Company's performance and oversight of the management. The management is responsible for the day-to-day operations of the Group under the guidance of the General Manager. As at 31 December 2005, the Board was comprised of nine Directors, including four executive Directors, two non-executive Directors and three independent non-executive Directors. Biographical details of the Directors are set out under the Directors and Senior Management section from pages 18 to 21. The independence of an Independent Non-executive Director may only be established upon confirmation by the Board that such Director does not have any other direct or indirect relationship with the Group. The Chairman of the Company, Mr. Zhang En Rong, is the father of Mr. Zhang Yun San, an executive Director. Aside from this, there is no financial, business and relatives relationship among members of the Board.

Eight meetings were held in 2005 by the Board with all Directors present.

		Number of meetings attended
Zhang En Rong	Chairman, Executive Director	8/8
Zhang Yun San	Deputy Chairman, Executive Director	8/8
Lin Fu Long	Executive Director, General Manager	8/8
Xie Xin Cang	Executive Director, Board Secretary	8/8
Chen Jian Xiong	Non-executive Director	8/8
Wang Ping	Non-executive Director	8/8
Qin Xue Chang	Independent non-executive Director	8/8
Yan Yi Zhuang	Independent non-executive Director	8/8
Loke Hoi Lam	Independent non-executive Director	8/8

(d) Chairman and General Manager

As the leader of the Board, the Chairman is responsible for the approval and supervision of the overall strategies and policies of the Group, approval of annual budgets and business plans, evaluation of the Company's performance and oversight of the management. The General Manager is responsible for the day-to-day operations of the Group. The roles of the Chairman and General Manager should be separate and should not be performed by the same individual.

(e) Non-executive Director

The appointment of non-executive Director, Mr. Chen Jian Xiong, is valid from 7 May 2005 to 7 May 2008. The appointment of non-executive Director, Mr. Wang Ping, is valid from 29 March 2003 to 29 March 2006.

(f) Directors' Nomination

The principal duties of the Nomination Committee are as follows:

1. to review the structure, size and composition (including in terms of expertise, knowledge and experience) of the Board on a regular basis;
2. to make recommendations to the Board regarding any proposed changes;
3. to identify candidates as directors and managers with appropriate qualifications;
4. to nominate Director candidates or advise the Board in this respect;
5. to assess the independence of Independent Non-Executive Directors; and
6. to make recommendations to the Board with respect to the appointment or reappointment or succession of Directors (particularly in respect of the Chairman of the Board and General Manager).

The Nomination Committee was established on 18 January 2005 and its members are Mr. Yan Yi Zhuang, Mr. Zhang Yun San, Mr. Qin Xue Chang and Mr. Loke Hoi Lam with Mr. Yan Yi Zhuang as the Chairman of the Committee.

One meeting of the Nomination Committee was held this year.

Members of the Nomination Committee		Number of meetings attended
Yan Yi Zhuang	Committee Chairman, Independent non-executive Director	1/1
Zhang Yun San	Deputy Chairman of the Board, Executive Director	1/1
Qin Xue Chang	Independent non-executive Director	1/1
Loke Hoi Lam	Independent non-executive Director	1/1

The Nomination Committee identifies Director candidates with appropriate qualification and advises the Board accordingly.

(g) Auditors' Remuneration

For the Relevant Period, auditing service fees payable to the Company's auditors amounted to approximately RMB1 million.

(h) Directors' Remuneration

The principal duties of the Remuneration and Evaluation Committee are as follows:

1. to make recommendation to the Board in respect of the overall remuneration policies and framework of the Directors and senior management members of the Company and in respect of the establishment of a set of official and transparent measures procedure in such remuneration policies;

2. to determine the specific remuneration packages of all executive Directors and senior management members and to make recommendation to the Board in respect of the remuneration of non-executive Directors;

3. to review and approve performance-based remuneration by reference to the corporate goals resolved by the Board from time to time;

4. to review and approve compensation payable to executive Directors and senior management members of the Company in connection with any loss or termination of office or appointment;

5. to review and approve the compensation arrangement relating to the dismissal or removal of a Director for misconduct;

6. to ensure that no Director or any of his associates is involved in deciding his own remuneration.

This Committee was established on 18 January 2005 and its members are Mr. Zhang Yun San, Mr. Qin Xue Chang, Mr. Yan Yi Zhuang and Mr. Loke Hoi Lam, who was also the Chairman of the Committee.

One meeting of the Remuneration and Evaluation Committee was held in the Relevant Period.

Members of the Remuneration and Evaluation Committee		Number of meetings attended
Loke Hoi Lam	Committee Chairman, Independent non-executive Director	1/1
Zhang Yun San	Deputy Chairman of the Board, Executive Director	1/1
Qin Xue Chang	Independent non-executive Director	1/1
Yan Yi Zhuang	Independent non-executive Director	1/1

The Remuneration Committee has determined the remuneration of the Directors according to their expertise, knowledge and commitment to the Company with reference to the Company's profitability and the prevailing market conditions.

(i) Audit Committee

The principal duties of the Audit Committee are as follows:

1. be responsible for making recommendation on the appointment, reappointment and removal of the external auditor;
2. to approve the remuneration and terms of engagement of the external auditor;
3. to monitor the external auditor's independence and objectivity and the effectiveness of the audit process;
4. be responsible for the formation of policy on the engagement of an external auditor in respect of non-audit services;
5. to monitor the integrity of financial statements and reports;
6. to review significant judgments involved in the financial reports;
7. to review the Company's financial control, internal control and risk management systems;
8. to review the financial and accounting policies and practices; and
9. to review the management letter from the external auditors and ensure prompt respond from the Board.

The Audit Committee was established on 20 March 2004 and its members are Mr. Qin Xue Chang, Mr. Yan Yi Zhuang and Mr. Loke Hoi Lam, with Mr. Qin Xue Chang as the Chairman of the Committee.

The Audit Committee has held five meetings this year to discuss matters relating to the accounting standards and practices adopted by the Group, and internal control and financial reporting matters, etc., including to review the audited results for the Relevant Period.

The Audit Committee had held meetings with the external auditors of the Company to discuss the quarterly reports, interim report and annual financial statements and the internal control system of the Company. Directors and Chief Financial Officer of the Company also attended the meetings to answer questions in respect of the financial results of the Company.

The management of the Company shall provide all ledgers, analyses and supporting documents as required by the Audit Committee to facilitate their review on the financial statements and control system of the Company to their satisfaction so that they may submit appropriate advice to the board.

Members of the Audit Committee	**Duties**	**Number of meetings attended**
Qin Xue Chang	Committee Chairman, Independent non-executive Director	5/5
Yan Yi Zhuang	Independent non-executive Director	5/5
Loke Hoi Lam	Independent non-executive Director	5/5

(j) The Directors confirmed their responsibilities in preparing the Group's financial statements.

The Directors have confirmed that the preparation of the Group's financial statement is in compliance with the relative regulations and applicable accounting standards. The Directors also warrant that the Group's financial statement will be distributed in due course.

(k) Internal Control

Upon review of the internal control system of the Company and its subsidiaries, the Board confirms that such internal control systems are effective.

(l) Going Concern

As of the Relevant Period, there was no uncertainty or conditions of a material nature that would affect the Company's ability as to continue as a going concern.

(m) Investor Relations

The Board Office of the Company is responsible for replying written and telephone enquiries from shareholders/investors. The Company maintains a hotline (86 536 5101565 - 8108) and an email address (dsh@molonggroup.com.cn) for such enquiries.

The Company cordially invites shareholders to express their opinions by filling out the feedback form enclosed with the annual report. Visits to our facilities in the PRC will also be arranged for shareholders. Opinions of the shareholders will be forwarded to the senior management members and the Directors.

The Company understands that not all shareholders and stakeholders have ready access to information online. If this is the case, please feel free send a written request to our Board Office at No. 99 Beihai Road, Shouguang City, Shandong Province, the PRC or email your request to dsh@molonggroup.com for a copy of the above online information.

ERNST & YOUNG
安永會計師事務所

■ Certified Public Accountants
18/F Two International Finance Centre,
8 Finance Street, Central, Hong Kong
■ Phone: 852 2846 9888
Fax: 852 2868 4432

To the members
Shandong Molong Petroleum Machinery Company Limited
(Registered in the People's Republic of China with limited liability)

We have audited the financial statements on pages 41 to 88 which have been prepared in accordance with accounting principles generally accepted in Hong Kong.

Respective responsibilities of directors and auditors

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

Basis of opinion

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

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

Opinion

In our opinion the financial statements give a true and fair view of the state of affairs of the Company and of the Group as at 31 December 2005 and of the profit and cash flows of the Group for the year then ended and have been properly prepared in accordance with the disclosure requirements of the Hong Kong Companies Ordinance.

Ernst & Young
Certified Public Accountants

Hong Kong
19 March 2006

Year ended 31 December 2005

	Notes	2005 RMB'000	2004 RMB'000
REVENUE	5	**776,522**	487,688
Cost of sales		**(596,113)**	(391,030)
Gross profit		**180,409**	96,658
Other income and gain	5	**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	7	**(3,444)**	(4,572)
PROFIT BEFORE TAX	6	**115,519**	65,576
Tax	10	**(27,271)**	(1,485)
PROFIT FOR THE YEAR		**88,248**	64,091
Attributable to:			
Equity holders of the parent	11	**85,227**	61,366
Minority interests		**3,021**	2,725
		88,248	64,091
DIVIDENDS	12		
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)	13	**0.141**	0.122

31 December 2005

	Notes	2005 RMB'000	2004 RMB'000 (Restated)
NON-CURRENT ASSETS			
Property, plant and equipment	14	**326,114**	124,330
Investment properties	15	**8,037**	—
Prepaid land lease payments	16	**20,201**	8,872
Intangible asset	17	**273**	112
Available-for-sale equity investment/ long term investment	19	**50**	50
Deferred tax assets	27	**5,238**	—
Total non-current assets		**359,913**	133,364
CURRENT ASSETS			
Inventories	20	**213,854**	140,284
Trade receivables	21	**75,744**	89,871
Notes receivable		**15,164**	—
Prepayments, deposits and other receivables	22	**14,681**	15,577
Due from related parties	34(b)(i)	**21,977**	—
Pledged deposits	23	**147,630**	61,886
Cash and bank balances	23	**110,166**	26,077
Total current assets		**599,216**	333,695
CURRENT LIABILITIES			
Trade and bills payables	24	**421,189**	169,096
Other payables and accruals	25	**38,877**	20,206
Tax payable		**23,355**	302
Interest-bearing bank loans	26	**50,000**	30,000
Due to related parties	34(b)(ii)	**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	28	**64,800**	54,000
Reserves	29	**334,359**	183,454
Proposed final dividend	12	**11,016**	8,100
		410,175	245,554
MINORITY INTERESTS		**4,891**	1,090
TOTAL EQUITY		**415,066**	246,644

Zhang Yun San
Director

Xie Xin Cang
Director

Year ended 31 December 2005

	Notes	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 (note 29)	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	28	13,500	89,169	—	—	—	89,169	—	102,669	—	102,669
Share issue expenses	28	—	(21,760)	—	—	—	(21,760)	—	(21,760)	—	(21,760)
Net profit for the year		—	—	—	—	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	12	—	—	—	—	(10,806)	(10,806)	—	(10,806)	—	(10,806)
Proposed final 2004 dividend	12	—	—	—	—	(8,100)	(8,100)	8,100	—	—	—
At 31 December 2004		54,000	88,036	16,039	8,019	71,360	183,454	8,100	245,554	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	28	10,800	94,831	—	—	—	94,831	—	105,631	—	105,631
Share issue expenses	28	—	(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	18 (b)	—	—	—	—	—	—	—	—	780	780
Transfer from retained profits to statutory funds		—	—	7,926	3,963	(11,889)	—	—	—	—	—
Interim 2005 dividend	12	—	—	—	—	(12,982)	(12,982)	—	(12,982)	—	(12,982)
Proposed final 2005 divdend	12	—	—	—	—	(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.

Year ended 31 December 2005

	Notes	2005 RMB'000	2004 RMB'000 (Restated)
CASH FLOWS FROM OPERATING ACTIVITES			
Profit before tax		**115,519**	65,576
Adjustments for:			
Finance costs	7	**3,444**	4,572
Investment income from a trust investment	5	**—**	(289)
Interest income	5	**(2,048)**	(1,029)
Gain on disposal of property, plant and equipment	5	**(204)**	(102)
Amortisation of know-how	6,17	**39**	8
Depreciation	6	**13,382**	9,056
Recognition of prepaid land lease payments	6	**276**	113
Operating profit before working capital changes		**130,408**	77,905
Increase in inventories		**(73,570)**	(72,299)
(Increase)/decrease in trade receivables		**14,127**	(34,552)
(Increase)/decrease in notes receivable		**(15,164)**	4,500
Decrease in prepayments, deposits and other receivables		**1,129**	39,550
(Increase)/decrease in amounts due from related parties		**(21,197)**	10,429
Increase in trade and bills payables		**252,093**	48,775
Increase/(decrease) in other payables and accruals		**18,671**	(27,050)
Increase in amounts due to related parties		**9,026**	811
Cash generated from operations		**315,523**	48,069
Interest paid		**(3,444)**	(4,572)
Income tax paid – all in Mainland China		**(9,456)**	(8,063)
Net cash inflow from operating activities		**302,623**	35,434

Year ended 31 December 2005

	Notes	2005 RMB'000	2004 RMB'000 (Restated)
Net cash inflow from operating activities		**302,623**	35,434
CASH FLOWS FROM INVESTING ACTIVITIES			
Investment income from a trust investment	5	**—**	289
Interest received	6	**2,048**	1,016
Purchases of property, plant and equipment	14	**(223,018)**	(55,772)
Additions to prepaid land lease payments	16	**(11,838)**	—
Additions to know-how	17	**(200)**	(120)
Proceeds from disposal of property, plant and equipment		**824**	290
Proceeds from disposal of a long term investment		**—**	6,000
Increase in pledged time deposits		**(41,667)**	3,637
Net cash outflow from investing activities		**(273,851)**	(44,660)
CASH FLOWS FROM FINANCING ACTIVITIES			
Proceeds from issue of shares	28	**105,631**	102,669
Share issue expenses	28	**(5,155)**	(21,760)
Capital contributed by a minority shareholder		**—**	600
New bank loans		**105,000**	38,000
Repayment of bank loans		**(85,000)**	(98,000)
Dividends paid	12	**(21,082)**	(10,806)
Dividends paid to a minority shareholder		**—**	(4,559)
Distribution of minority interests		**—**	(2,477)
Net cash inflow from financing activities		**99,394**	3,667
NET INCREASE/(DECREASE) IN CASH AND CASH EQUIVALENTS		**128,166**	(5,559)
Cash and cash equivalents at beginning of year		**57,528**	63,087
CASH AND CASH EQUIVALENTS AT END OF YEAR		**185,694**	57,528
ANALYSIS OF BALANCES OF CASH AND CASH EQUIVALENTS			
Cash and bank balances	23	**110,166**	26,077
Time deposits with original maturity of less than three months when acquired, pledged as security for bills payable		**75,528**	31,451
		185,694	57,528

Balance Sheet

31 December 2005

	Notes	2005 RMB'000	2004 RMB'000 (Restated)
NON-CURRENT ASSETS			
Property, plant and equipment	14	**316,523**	117,655
Investment properties	15	**10,302**	—
Prepaid land lease payments	16	**20,201**	8,872
Intangible asset	17	**273**	112
Interests in subsidiaries	18	**12,420**	24,852
Available-for-sale equity investment/long term investment	19	**50**	50
Deferred tax assets	27	**5,238**	—
Total non-current assets		**365,007**	151,541
CURRENT ASSETS			
Inventories	20	**176,474**	115,180
Trade receivables	21	**75,338**	89,871
Notes receivable		**15,163**	—
Prepayments, deposits and other receivables	22	**12,818**	15,537
Due from related parties	34(b)(i)	**21,197**	—
Pledged deposits	23	**147,630**	61,886
Cash and bank balances	23	**107,312**	25,837
Total current assets		**555,932**	308,311
CURRENT LIABILITIES			
Trade and bills payables	24	**401,795**	166,020
Other payables and accruals	25	**36,508**	22,245
Tax payable		**23,826**	302
Interest-bearing bank loans	26	**50,000**	30,000
Due to subsidiaries	18	**21,989**	—
Due to related parties	34(b)(ii)	**8,241**	138
Total current liabilities		**542,359**	218,705
NET CURRENT ASSETS		**13,573**	89,606
TOTAL ASSETS LESS CURRENT LIABILITIES		**378,580**	241,147
Net assets		**378,580**	241,147
EQUITY			
Issued capital	28	**64,800**	54,000
Reserves	29	**302,764**	179,047
Proposed final dividend	12	**11,016**	8,100
Total equity		**378,580**	241,147

Zhang Yun San
Director

Xie Xin Cang
Director

31 December 2005

1. CORPORATE INFORMATION

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

During the year, the Company and its subsidiaries (the "**Group**") were involved in the design, manufacture and sale of petroleum extraction machinery and related accessories, which included oil well pipes, oil well sucker rods, oil well pumps, casing and oil well pumping machines.

2.1 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.

31 December 2005

2.2 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.

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2.2 IMPACT OF NEW AND REVISED HONG KONG FINANCIAL REPORTING STANDARDS *(continued)*

HKAS 1 - Presentation of Financial Statements

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 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.

HKAS 24 - Related Party Disclosures

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

2.3 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.

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2.3 IMPACT OF ISSUED BUT NOT YET EFFECTIVE HONG KONG FINANCIAL REPORTING STANDARDS *(continued)*

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.

2.4 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))	Note	**Prepaid land lease payments**
		RMB'000
Assets		
Property, plant and equipment		(9,128)
Prepaid land lease payments	16	8,872
Prepayments, deposits and other receivables		256
		—

At 31 December 2005		HKAS 17
Effect of new policies (Increase/(decrease))	Note	**Prepaid land lease payments**
		RMB'000
Assets		
Property, plant and equipment		(20,690)
Prepaid land lease payments	16	20,201
Prepayments, deposits and other receivables		489
		—

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2.5 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Subsidiaries

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

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

Impairment of assets

Where an indication of impairment exists, or when annual impairment testing for an asset is required (other than inventories, deferred tax assets and financial assets), the asset's recoverable amount is estimated. An asset's recoverable amount is calculated as the higher of the asset's or cash-generating unit's value in use and its fair value less costs to sell, and is determined for an individual asset, unless the asset does not generate cash inflows that are largely independent of those from other assets or groups of assets, in which case, the recoverable amount is determined for the cash-generating unit to which the asset belongs.

An impairment loss is recognised only if the carrying amount of an asset exceeds its recoverable amount. In assessing value in use, the estimated future cash flows are discounted to their present values using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. An impairment loss is charged to the income statement in the period in which it arises.

An assessment is made at each reporting date as to whether there is any indication that previously recognised impairment losses may no longer exist or may have decreased. If such indication exists, the recoverable amount is estimated. A previously recognised impairment loss of an asset other than goodwill is reversed only if there has been a change in the estimates used to determine the recoverable amount of that asset, however not to an amount higher than the carrying amount that would have been determined (net of any depreciation/amortisation), had no impairment loss been recognised for the asset in prior years. A reversal of such impairment loss is credited to the income statement in the period in which it arises.

2.5 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Related parties

A party is considered to be related to the Group if:

(a) directly, or indirectly through one or more intermediaries, the party

(i) controls, is controlled by, or is under common control with, the Group;

(ii) has an interest in the Group that gives it significant influence over the Group; or

(iii) has joint control over the Group;

(b) the party is an associate;

(c) the party is a jointly-controlled entity;

(d) the party is a member of the key management personnel of the Group or its parent;

(e) the party is a close member of the family of any individual referred to in (a) or (d); or

(f) the party is an entity that is controlled, jointly controlled or significantly influenced by or for which significant voting power in such entity resides with, directly or indirectly, any individual referred to in (d) or (e).

Property, plant and equipment and depreciation

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

Depreciation is calculated on the straight-line basis to write off the cost of each item of property, plant and equipment to its residual value over its estimated useful life. The estimated useful lives of the items are as follows:

Buildings	20 years
Plant and machinery	2 - 10 years
Electronic equipment	5 years
Motor vehicles	5 years
Other equipment	5 years

Where parts of an item of property, plant and equipment have different useful lives, the cost of that item is allocated on a reasonable basis among the parts and each part is depreciated separately.

Residual values, useful lives and depreciation method are reviewed, and adjusted if appropriate, at each balance sheet date.

2.5 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Property, plant and equipment and depreciation *(continued)*

An item of property, plant and equipment is derecognised upon disposal or when no future economic benefits are expected from its use or disposal. Any gain or loss on disposal of property, plant and equipment recognised in the income statement in the year the asset is derecognised is the difference between the net sales proceeds and the carrying amount of the relevant asset.

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

Investment properties

Investment properties are interests in land and buildings held to earn rental income, rather than for use in the production or supply of goods or services, or for administrative purposes; or for sale in the ordinary course of business. Such properties are measured initially at cost, including transaction costs. Subsequent to initial recognition, investment properties are stated at cost less accumulated depreciation and any impairment losses.

Any gains or losses on the retirement or disposal of an investment property are recognised in the income statement in the year of the retirement or disposal.

Intangible assets (other than goodwill)

Intangible assets with finite lives are amortised over the useful economic life and assessed for impairment whenever there is an indication that the intangible asset may be impaired. The amortisation period and the amortisation method for an intangible asset with a finite useful life are reviewed at least at each balance sheet date.

Know-how

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

Research and development costs

All research costs are charged to the income statement as incurred.

Operating leases

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

2.5 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Investments and other financial assets

Applicable to the year ended 31 December 2004:

Long term investments

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

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

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

Applicable to the year ended 31 December 2005:

Financial assets in the scope of HKAS 39 are classified as financial assets at fair value through profit or loss, loans and receivables and available-for-sale financial assets, as appropriate. When financial assets are recognised initially, they are measured at fair value, plus, in the case of investments not at fair value through profit or loss, directly attributable transaction costs. The Group determines the classification of its financial assets after initial recognition and, where allowed and appropriate, re-evaluates this designation at the balance sheet date.

All regular way purchases and sales of financial assets are recognised on the trade date, i.e., the date that the Group commits to purchase the asset. Regular way purchases or sales are purchases or sales of financial assets that require delivery of assets within the period generally established by regulation or convention in the marketplace.

Financial assets at fair value through profit or loss

Financial assets classified as held for trading are included in the category "financial assets at fair value through profit or loss". Financial assets are classified as held for trading if they are acquired for the purpose of sale in the near term. Gains or losses on investments held for trading are recognised in the income statement.

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Such assets are carried at amortised cost using the effective interest method. Gains and losses are recognised in the income statement when the loans and receivables are derecognised or impaired, as well as through the amortisation process.

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2.5 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Investments and other financial assets *(continued)*

Available-for-sale financial assets

Available-for-sale financial assets are those non-derivative financial assets in listed and unlisted equity securities that are designated as available for sale or are not classified in any of the other two categories. After initial recognition, available for sale financial assets are measured at fair value with gains or losses being recognised as a separate component of equity until the investment is derecognised or until the investment is determined to be impaired, at which time the cumulative gain or loss previously reported in equity is included in the income statement.

When the fair value of unlisted equity securities cannot be reliably measured because (a) the variability in the range of reasonable fair value estimates is significant for that investment or (b) the probabilities of the various estimates within the range cannot be reasonably assessed and used in estimating the fair value, such securities are stated at cost less any impairment losses.

Fair value

The fair value of investments that are actively traded in organised financial markets is determined by reference to quoted market bid prices at the close of business at the balance sheet date. For investments where there is no active market, fair values are determined by using valuation techniques. Such techniques include using recent arm's length market transactions; reference to the current market value of another instrument, which is substantially the same; a discounted cash flow analysis, and option pricing models.

2.5 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Impairment of financial assets

The Group assesses at each balance sheet date whether there is any objective evidence that a financial asset or group of financial assets is impaired.

Assets carried at amortised cost

If there is objective evidence that an impairment loss on receivables carried at amortised cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate (i.e., the effective interest rate computed at initial recognition). The carrying amount of the asset is reduced either directly or through the use of an allowance account. The amount of the impairment loss is recognised in profit or loss.

The Group first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant. If it is determined that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, the asset is included in a group of financial assets with similar credit risk characteristics and that group is collectively assessed for impairment. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed. Any subsequent reversal of an impairment loss is recognised in the income statement, to the extent that the carrying value of the asset does not exceed its amortised cost at the reversal date.

Assets carried at cost

If there is objective evidence that an impairment loss on an unquoted equity instrument that is not carried at fair value because its fair value cannot be reliably measured, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the current market rate of return for a similar financial asset. Impairment losses on these assets are not reversed.

Available-for-sale financial assets

If an available-for-sale asset is impaired, an amount comprising the difference between its cost (net of any principal payment and amortisation) and its current fair value, less any impairment loss previously recognised in profit or loss, is transferred from equity to the income statement. Impairment losses on equity instruments classified as available for sale are not reversed through profit or loss.

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2.5 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Interest-bearing loans

All loans are initially recognised at the fair value of the consideration received less directly attributable transaction costs.

After initial recognition, interest-bearing loans are subsequently measured at amortised cost using the effective interest method.

Gains and losses are recognised in net profit or loss when the liabilities are derecognised as well as through the amortisation process.

Inventories

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

Cash and cash equivalents

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

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

Income tax

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

Current tax assets and liabilities for the current and prior periods are measured at the amount expected to be recovered from or paid to the taxation authorities.

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

Deferred tax liabilities are recognised for all taxable temporary differences, except:

- where the deferred tax liability arises from goodwill or the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and

- in respect of taxable temporary differences associated with investments in subsidiaries, where the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future.

2.5 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Income tax *(continued)*

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

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

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilised. Conversely, previously unrecognised deferred tax assets are reassessed at each balance sheet date and are recognised to the extent that it is probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilised.

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

Deferred tax assets and deferred tax liabilities are offset, if a legally enforceable right exists to set off current tax assets against current tax liabilities and the deferred taxes relate to the same taxable entity and the same taxation authority.

Government grants and subsidies

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

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2.5 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Revenue recognition

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

(a) from the sale of goods, when the significant risks and rewards of ownership have been transferred to the buyer, provided that the Group maintains neither managerial involvement to the degree usually associated with ownership, nor effective control over the goods sold;

(b) from the rendering of services, on the percentage of completion basis.

(c) rental income, on a time proportion basis over the lease terms;

(d) interest income, on an accrual basis using the effective interest method by applying the rate that discounts the estimated future cash receipts through the expected life of the financial instrument to the net carrying amount of the financial asset; and

(e) value added tax ("**VAT**") refunds, when the acknowledgment of a refund from the PRC tax bureau has been received.

Retirement benefits

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

Borrowing costs

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

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2.5 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Dividends

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

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

Foreign currencies

These financial statements are presented in Renminbi ("**RMB**"), which is the Group's functional and presentation currency.

Foreign currency transactions are initially recorded using the functional currency rates ruling at the date of the transactions. Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency rates of exchange ruling at the balance sheet date. All differences are taken to profit or loss.

3. SIGNIFICANT ACCOUNTING JUDGEMENTS AND ESTIMATES

Judgements

In the process of applying the Group's accounting policies, management has made the following judgements, apart from those involving estimations, which have the most significant effect on the amounts recognised in the financial statements:

Operating lease commitments - Group as lessor

The Group has entered into commercial property leases on its investment property portfolio. The Group has determined that it retains all the significant risks and rewards of ownership of these properties which are leased out on operating leases.

Classification between investment properties and owner-occupied properties

The Group determines whether a property qualifies as an investment property and has developed criteria in making that judgement. Investment property is a property held to earn rentals or for capital appreciation or both. Therefore, the Group considers whether a property generates cash flows largely independently of the other assets held by the Group.

Some properties comprise a portion that is held to earn rentals or for capital appreciation and another portion that is held for use in the production or supply of goods or services or for administrative purposes. If these portions could be sold separately (or leased out separately under a finance lease), the Group accounts for the portions separately. If the portions could not be sold separately, the property is an investment property only if an insignificant portion is held for use in the production or supply of goods or services or for administrative purposes.

Judgement is made on an individual property basis to determine whether ancillary services are so significant that a property does not qualify as investment property.

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3. SIGNIFICANT ACCOUNTING JUDGEMENTS AND ESTIMATES *(continued)*

Estimation uncertainty

The key assumptions concerning the future and other key sources of estimation uncertainty at the balance sheet date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year, are discussed below.

(i) *Provision against slow-moving inventories*

Provision for slow-moving inventories is made based on the aging and estimated net realisable value of inventories. The assessment of the provision amount required involves management judgement and estimates. Where the actual outcome or expectation in future is different from the original estimate, such differences will impact the carrying value of inventories and provision charge/write-back in the period in which such estimate has been changed.

(ii) *Provision for doubtful debts*

Provision for doubtful debts is made based on assessment of the recoverability of trade receivables and other receivables. The identification of doubtful debts requires management judgement and estimates. Where the actual outcome or expectation in future is different from the original estimate, such differences will impact the carrying value of the receivables and doubtful debt expenses/write-back in the period in which such estimate has been changed.

(iii) *Impairment of property, plant and equipment*

The carrying value of the property, plant and equipment is reviewed for impairment when events or changes in circumstances indicate the carrying value may not be recoverable in accordance with the accounting policies as disclosed at section 2.5. The recoverable amount of the property, plant and equipment is the greater of fair value less costs to sell and value in use, the calculations of which involve the use of estimates.

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4. SEGMENT INFORMATION

Segment information is presented by way of the Group's primary segment reporting basis, by geographical segment. The Group's operating business is with customers based in 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.

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		Other countries		Consolidated	
	2005 RMB'000	2004 RMB'000	**2005 RMB'000**	2004 RMB'000	**2005 RMB'000**	2004 RMB'000	**2005 RMB'000**	2004 RMB'000	**2005 RMB'000**	2004 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

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

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4. SEGMENT INFORMATION *(continued)*

	The PRC		United States		Europe		Other countries		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 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

5. 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 are as follows:

		Group	
	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	6	**2,048**	1,029
Government subsidies	(i)	**710**	3,019
VAT refund	(ii)	**2,165**	9,168
Rental income	6	**153**	98
Sale of raw materials	(iii)	**7,559**	1,122
Others		**965**	185
		13,942	15,356
Gain			
Gain on disposal of items of property, plant and equipment	6	**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" 國家稅務局關於民政福利企業徵收流轉稅問題的通知 , 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.

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6. PROFIT BEFORE TAX

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

	Notes	Group 2005 RMB'000	Group 2004 RMB'000 (Restated)
Cost of inventories sold		**596,113**	391,030
Depreciation	14, 15	**13,382**	9,056
Amortisation of know-how	17	**39**	8
Recognition of prepaid land lease payments	16	**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 (note 8)):			
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	5	**(153)**	(98)
Bank interest income	5	**(2,048)**	(1,029)
Gain on disposal of items of property, plant and equipment	5	**(204)**	(102)

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7. FINANCE COSTS

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

8. DIRECTORS' REMUNERATION

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

	Group	
	2005	2004
	RMB'000	RMB'000
Fees	**—**	—
Other remuneration:		
Salaries, allowances and benefits in kind	**270**	243
Performance related bonuses	**578**	540
Retirement benefits scheme contributions	**9**	6
	857	789

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

(a) Independent non-executive directors

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

	2005	2004
	RMB'000	RMB'000
Mr. Qin Xue Chang（秦學昌）	**30**	30
Mr. Yan Yi Zhuang（閆翊莊）	**63**	64
Mr. Loke Yu alias Loke Hoi Lam（陸海林）	**63**	50
	156	144

There were no other remuneration payable to the independent non-executive directors during the year (2004: Nil).

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8. DIRECTORS' REMUNERATION *(continued)*

(b) Executive directors and non-executive directors

	Salaries, allowances and benefits in kind RMB'000	Performance related bonuses RMB'000	Retirement benefits scheme contributions RMB'000	Total RMB'000
2005				
Executive directors:				
Mr. Zhang En Rong（張恩榮）	**32**	**208**	**—**	**240**
Mr. Zhang Yun San（張雲三）	**28**	**135**	**3**	**166**
Mr. Lin Fu Long（林福龍）	**26**	**135**	**3**	**164**
Mr. Xie Xin Cang（謝新倉）	**28**	**100**	**3**	**131**
	114	**578**	**9**	**701**
Non-executive directors:				
Mr. Chen Jian Xiong（陳建雄）	**—**	**—**	**—**	**—**
Mr. Wang Ping（王平）	**—**	**—**	**—**	**—**
	114	**578**	**9**	**701**
2004				
Executive directors:				
Mr. Zhang En Rong（張恩榮）	28	189	—	217
Mr. Zhang Yun San（張雲三）	25	122	2	149
Mr. Lin Fu Long（林福龍）	20	137	2	159
Mr. Xie Xin Cang（謝新倉）	26	92	2	120
	99	540	6	645
Non-executive directors:				
Mr. Chen Jian Xiong（陳建雄）	—	—	—	—
Mr. Wang Ping（王平）	—	—	—	—
	99	540	6	645

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

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9. FIVE HIGHEST PAID EMPLOYEES

The five highest paid employees during the year included four (2004: four) directors, details of whose remuneration are set out in note 8 above. Details of the remuneration of the remaining one (2004: one) non-director, highest paid employee for the year are as follows:

	Group	
	2005	2004
	RMB'000	RMB'000
Salaries, allowances and benefits in kind	**192**	20
Performance related bonuses	**—**	98
Retirement benefits scheme contributions	**—**	2
	192	120

10. 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*（關於企業所得税若干優惠政策的通知）.

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10. TAX *(continued)*

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 (note 27)	**(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

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11. 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) (note 29(b)).

12. 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.

13. 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.

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14. PROPERTY, PLANT AND EQUIPMENT

Group

(Restated)	Buildings RMB'000	Plant and machinery RMB'000	Electronic equipment RMB'000	Motor vehicles RMB'000	Other equipment RMB'000	Construction in progress RMB'000	Total RMB'000
Cost							
At 1 January 2004	27,685	59,513	1,554	5,434	1,978	755	96,919
Additions	2,219	12,514	237	1,008	244	39,550	55,772
Transfers from construction in progress	—	1,891	—	—	—	(1,891)	—
Disposals	—	(231)	—	(381)	—	—	(612)
At 31 December 2004	29,904	73,687	1,791	6,061	2,222	38,414	152,079
Additions	523	19,899	354	1,742	657	199,843	223,018
Transfers from construction in progress	52,685	2,461	—	—	24	(55,170)	—
Transfers from a related party (note 34(a))	—	1,300	—	—	—	—	1,300
Transfers to investment properties (note15)	(8,069)	—	—	—	—	—	(8,069)
Disposals	(229)	(708)	(72)	(953)	(34)	—	(1,996)
At 31 December 2005	74,814	96,639	2,073	6,850	2,869	183,087	366,332
Accumulated depreciation							
At 1 January 2004	3,575	12,598	359	2,008	577	—	19,117
Depreciation during the year	1,443	6,073	304	973	263	—	9,056
Disposals	—	(112)	—	(312)	—	—	(424)
At 31 December 2004	5,018	18,559	663	2,669	840	—	27,749
Depreciation during the year	1,611	9,874	324	1,121	420	—	13,350
Transfers from a related party (note 34(a))	—	495	—	—	—	—	495
Disposals	(45)	(294)	(72)	(939)	(26)	—	(1,376)
At 31 December 2005	6,584	28,634	915	2,851	1,234	—	40,218
Net carrying amount							
At 31 December 2005	68,230	68,005	1,158	3,999	1,635	183,087	326,114
At 31 December 2004	24,886	55,128	1,128	3,392	1,382	38,414	124,330

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14. PROPERTY, PLANT AND EQUIPMENT

Company

(Restated)	Buildings RMB'000	Plant and machinery RMB'000	Electronic equipment RMB'000	Motor vehicles RMB'000	Other equipment RMB'000	Construction in progress RMB'000	Total RMB'000
Cost							
At 1 January 2004	27,467	34,647	1,383	3,764	1,927	755	69,943
Additions	2,076	11,176	191	879	240	39,550	54,112
Transfers from a subsidiary	347	16,100	217	1,739	55	—	18,458
Transfers from construction in progress	—	1,891	—	—	—	(1,891)	—
Disposals	—	(231)	—	(321)	—	—	(552)
At 31 December 2004	29,890	63,583	1,791	6,061	2,222	38,414	141,961
Additions	588	19,444	352	1,742	646	199,804	222,576
Transfers from construction in progress	52,632	2,514	—	—	24	(55,170)	—
Transfers from a related party (note 34(a))	—	1,300	—	—	—	—	1,300
Transfers to investment properties (note 15)	(12,123)	—	—	—	—	—	(12,123)
Disposals	(229)	(3,582)	(90)	(953)	(34)	—	(4,888)
At 31 December 2005	70,758	83,259	2,053	6,850	2,858	183,048	348,826
Accumulated depreciation							
At 1 January 2004	3,429	3,886	275	1,187	482	—	9,259
Depreciation during the year	1,429	3,902	279	773	324	—	6,707
Transfers from a subsidiary	158	7,443	108	1,021	34	—	8,764
Disposals	—	(112)	—	(312)	—	—	(424)
At 31 December 2004	5,016	15,119	662	2,669	840	—	24,306
Depreciation during the year	1,316	8,788	322	1,121	418	—	11,965
Transfers from a related party (note 34(a))	—	495	—	—	—	—	495
Transfers to investment properties (note 15)	(1,492)	—	—	—	—	—	(1,492)
Disposals	(45)	(1,883)	(78)	(939)	(26)	—	(2,971)
At 31 December 2005	4,795	22,519	906	2,851	1,232	—	32,303
Net carrying amount							
At 31 December 2005	65,963	60,740	1,147	3,999	1,626	183,048	316,523
At 31 December 2004	24,874	48,464	1,129	3,392	1,382	38,414	117,655

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14. PROPERTY, PLANT AND EQUIPMENT *(continued)*

At 31 December 2005, none of the Group's machinery was pledged to secure to the Group's bank loans (2004: RMB13,155,000) (note 26).

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

15. INVESTMENT PROPERTIES

	Notes	Group RMB'000	Company RMB'000
Cost:			
At 1 January 2005		—	—
Transferred from property, plant and equipment	14	8,069	12,123
At 31 December 2005		8,069	12,123
Accumulated depreciation:			
At 1 January 2005		—	—
Transferred from property, plant and equipment	14	—	1,492
Recognised depreciation in current year		32	329
At 31 December 2005		32	1,821
Carrying amount at 31 December 2005		8,037	10,302

As at 31 December 2005, the fair value of the Group's investment properties was RMB9,373,000, which was based on a valuation by Shouguang Lu Dong Certified Public Accountants, an independent professionally qualified valuer, on an open market, existing use basis. The investment properties are leased to related parties under operating leases.

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16. PREPAID LAND LEASE PAYMENTS

	Group and Company	
	2005	2004
	RMB'000	RMB'000
Carrying amount at 1 January		
As previously reported	**—**	—
Effect of adopting HKAS 17 (note 2.4)	**9,128**	9,241
As restated	**9,128**	9,241
Additions	**11,838**	—
Recognised during the year	**(276)**	(113)
Carrying amount at 31 December	**20,690**	9,128
Current portion included in prepayments, deposits and other receivables	**(489)**	(256)
Non-current portion	**20,201**	8,872

The leasehold lands are situated in the Mainland China and, are held under a medium lease term.

17. INTANGIBLE ASSET

	Group and Company	
	2005	2004
	RMB'000	RMB'000
Know-how		
Cost at 1 January, net of accumulated amortisation	**112**	—
Additions	**200**	120
Amortisation provided during the year	**(39)**	(8)
At 31 December	**273**	112
At 31 December		
Cost	**320**	120
Accumulated amortisation	**(47)**	(8)
Net carrying amount	**273**	112

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18. INTERESTS IN SUBSIDIARIES/DUE TO SUBSIDIARIES

	Company	
	2005	2004
	RMB'000	RMB'000
Unlisted shares, at cost	**12,420**	5,400
Due from a subsidiary	**—**	19,452
Due to subsidiaries	**(21,989)**	—
	(9,569)	24,852

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

Particulars of the principal subsidiaries are as follows:

Name	Place of incorporation/ registration and operations	Nominal value of issued ordinary/ registered share capital	Percentage of equity directly attributable to the Company	Principal activities
Weifang Molong Drilling Equipment Company Limited ("**Molong Drilling Equipment**") (a)	PRC/ Mainland China	RMB6,000,000	90	Manufacture and sale of petroleum extraction machinery
Molong (Asia) Holding Limited ("**Molong Asia**") (b)	Hong Kong	HK$7,800,000	90	Trading petroleum extraction machinery and electro-mechanical equipment

Notes:

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

(b) On 28 March 2005, the Company obtained approval from the Department of Foreign Trade and Economic Cooperation ("FTEC") of Shandong Province approval document "Lu Wai Jing Mao Jing Wai [2005] No.125", pursuant to which the Company was authorised to set up a new subsidiary in Hong Kong. Molong Asia has no trading activity during the year.

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19. AVAILABLE-FOR-SALE EQUITY INVESTMENT/LONG TERM INVESTMENT

	Group and Company	
	2005	2004
	RMB'000	RMB'000
Unlisted equity investment, at cost	**50**	50
	50	50

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

20. INVENTORIES

	Group		Company	
	2005	2004	**2005**	2004
	RMB'000	RMB'000	**RMB'000**	RMB'000
Raw materials	**60,670**	42,546	**44,757**	36,080
Work in progress	**60,466**	34,158	**56,569**	31,716
Finished goods	**92,718**	63,580	**75,148**	47,384
	213,854	140,284	**176,474**	115,180

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

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21. TRADE RECEIVABLES

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

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

	Group		**Company**	
	2005	2004	**2005**	2004
	RMB'000	RMB'000	**RMB'000**	RMB'000
Within three months	**73,461**	81,408	**73,055**	81,408
Three to six months	**999**	7,746	**999**	7,746
Six months to one year	**1,284**	717	**1,284**	717
	75,744	89,871	**75,338**	89,871

22. PREPAYMENTS, DEPOSITS AND OTHER RECEIVABLES

	Group		**Company**	
	2005	2004	**2005**	2004
	RMB'000	RMB'000	**RMB'000**	RMB'000
		(Restated)		(Restated)
Prepayments	**13,578**	13,421	**11,797**	13,381
Deposits and other receivables	**1,103**	2,156	**1,021**	2,156
	14,681	15,577	**12,818**	15,537

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23. CASH AND BANK BALANCES AND PLEDGED DEPOSITS

	Note	Group 2005 RMB'000	Group 2004 RMB'000 (Restated)	Company 2005 RMB'000	Company 2004 RMB'000 (Restated)
Cash and bank balances		**110,166**	26,077	**107,312**	25,837
Time deposits pledged as security for bills payable	24	**147,630**	61,886	**147,630**	61,886
		257,796	87,963	**254,942**	87,723
Less: Time deposits with original maturity of over three months when acquired, pledged as security for bills payable		**(72,102)**	(30,435)	**(72,102)**	(30,435)
Cash and cash equivalents		**185,694**	57,528	**182,840**	57,288

At the balance sheet date, the cash and bank balances of the Group denominated in RMB amounted to RMB255,672,000 (2004: RMB87,960,000). The RMB is not freely convertible into other currencies, however, under the PRC Foreign Exchange Control Regulations and Administration of Settlement, Sale and Payment of Foreign Exchange Regulations, the Group is permitted to exchange RMB for other currencies through banks authorised to conduct foreign exchange business.

The carrying amounts of the cash and bank balances and the pledged deposits approximate to their fair values.

24. TRADE AND BILLS PAYABLES

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

	Group 2005 RMB'000	Group 2004 RMB'000	Company 2005 RMB'000	Company 2004 RMB'000
Within three months	**237,954**	102,871	**219,720**	100,281
Three to six months	**173,551**	62,893	**172,959**	62,493
Six months to one year	**4,752**	1,690	**4,206**	1,631
One to two years	**3,946**	1,642	**3,924**	1,615
Two to three years	**986**	—	**986**	—
	421,189	169,096	**401,795**	166,020

The Group and the Company's bills payable of RMB325,711,000 (2004: RMB124,822,000) were secured by the pledge of certain of the time deposits amounting to RMB147,630,000 (2004: RMB 61,886,000) (note 23). The trade payables are non-interest-bearing and are normally settled on terms of 6 months.

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25. OTHER PAYABLES AND ACCRUALS

	Group		Company	
	2005	2004	**2005**	2004
	RMB'000	RMB'000	**RMB'000**	RMB'000
Advance from customers	**7,863**	10,573	**7,863**	10,570
Payroll payable	**11,675**	2,565	**10,614**	2,269
Welfare payable	**2,416**	2,458	**2,090**	2,417
Other payables	**10,938**	2,659	**10,325**	5,585
Accruals	**5,985**	1,951	**5,616**	1,404
	38,877	20,206	**36,508**	22,245

Other payables are non-interest-bearing and have an average term of three months.

26. INTEREST-BEARING BANK LOANS

	Effective interest rate (%)	Maturity	Group **2005** **RMB'000**	Group 2004 RMB'000	Company **2005** **RMB'000**	Company 2004 RMB'000
Current						
Secured	—	—	**—**	15,000	**—**	15,000
Unsecured	5.58	2006	**50,000**	15,000	**50,000**	15,000
			50,000	30,000	**50,000**	30,000

	Group		Company	
	2005	2004	**2005**	2004
	RMB'000	RMB'000	**RMB'000**	RMB'000
Analysed into:				
Bank loans repayable:				
Within one year	**50,000**	30,000	**50,000**	30,000

At 31 December 2004, the Group's loans are secured by mortgages over the Group's machinery, which had an aggregate net book value at the balance sheet date of approximately RMB13,155,000 (note 14). All borrowings are in RMB at fixed interest rates.

The carrying amounts of the Group's and the Company's borrowings approximate to their fair values.

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27. DEFERRED TAX

The movement in deferred tax assets are as follows:

Deferred tax assets

	Group and Company	
	2005 Provision available for offset against future taxable profit RMB'000	2004 Provision available for offset against future taxable profit RMB'000
At 1 January	**—**	—
Deferred tax credit to the income statement during the year (note 10)	**5,238**	—
Gross deferred tax assets at 31 December	**5,238**	—

There are no income tax consequences attaching to the payment of dividends by the Company to its shareholders.

28. SHARE CAPITAL

	Group and Company	
Shares	**2005 RMB'000**	2004 RMB'000
Authorised:		
647,998,000 (2004: 539,998,000) ordinary shares of RMB0.10 (2004: RMB0.10) each	**64,800**	54,000
Issued and fully paid:		
647,998,000 (2004: 539,998,000) ordinary shares of RMB0.10 (2004: RMB0.10) each	**64,800**	54,000

(a) Pursuant to the approval document by China Securities Regulatory Commission (the "CSRC"), Zheng Jian Guo He Zi [2005] No.13, the Company was authorised to issue new H shares. On 26 April 2005, 108,000,000 ordinary shares of RMB0.10 each were issued to the public by way of public offering at a price of HK$0.92 (equivalent to approximately RMB0.9781) per share. The net proceeds from the above share offer, after deducting the related underwriting and other expenses, were RMB100,476,000.

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28. SHARE CAPITAL *(continued)*

(b) The Company's H shares are listed on the GEM of the Stock Exchange at present. Pursuant to the special resolution (the "**Special Resolution**") passed in the extraordinary general meeting (the "**EGM**") and the two separate class meetings held on 30 December 2005 respectively, the Board is authorised to propose migration of the listing of the H shares from the GEM to the Main Board of the Stock Exchange.

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

		Number of shares in issue	Issued share capital	Capital Reserve	Total
			RMB'000	RMB'000	RMB'000
At 1 January 2004		405,000,000	40,500	20,627	61,127
Issue of shares		134,998,000	13,500	89,169	102,669
Share issue expenses		—	—	(21,760)	(21,760)
At 1 January 2005		539,998,000	54,000	88,036	142,036
Issue of shares	(a)	108,000,000	10,800	94,831	105,631
Share issue expenses		—	—	(5,155)	(5,155)
At 31 December 2005		647,998,000	64,800	177,712	242,512

29. RESERVES

(a) Group

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 43 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.

29. RESERVES *(continued)*

(b) Company

	Notes	Capital reserve RMB'000	Statutory reserve fund RMB'000	Statutory welfare fund RMB'000	Retained profits RMB'000	Total RMB'000
Balance at 1 January 2004		18,568	2,636	1,317	(6,683)	15,838
Issue of shares	28	89,169	—	—	—	89,169
Share issue expenses	28	(21,760)	—	—	—	(21,760)
Net profit for the year	11	—	—	—	114,706	114,706
Interim 2004 dividend	12	—	—	—	(10,806)	(10,806)
Proposed final 2004 dividend	12	—	—	—	(8,100)	(8,100)
Transfers		—	6,136	3,068	(9,204)	—
At 31 December 2004		85,977	8,772	4,385	79,913	179,047
Issue of shares		94,831	—	—	—	94,831
Share issue expenses		(5,155)	—	—	—	(5,155)
Net profit for the year	11	—	—	—	58,039	58,039
Interim 2005 dividend	12	—	—	—	(12,982)	(12,982)
Proposed final 2005 dividend	12	—	—	—	(11,016)	(11,016)
Transfers		—	7,926	3,963	(11,889)	—
At 31 December 2005		175,653	16,698	8,348	102,065	302,764

For the details of the statutory funds, please refer to the consolidated statement of changes in equity on pages 43 of the financial statements.

30. CONTINGENT LIABILITIES

As at 31 December 2004 and 2005, neither the Group, nor the Company had any significant contingent liabilities.

31. PLEDGE OF ASSETS

There were no assets pledged for bank loans at the balance sheet date. Details of bank loans at 31 December 2004, which were secured by certain assets of the Group, are included in note 26 to the financial statements.

31 December 2005

32. OPERATING LEASE ARRANGEMENTS

(a) As lessor

The Group leases its investment properties (note 15 to the financial statements) under operating lease arrangements, with leases negotiated for terms ranging from 10 to 20 years.

At 31 December 2005, the Group had total future minimum lease receivables under non-cancellable operating leases with its tenants falling due as follows:

	Group		Company	
	2005	2004	**2005**	2004
	RMB'000	RMB'000	**RMB'000**	RMB'000
Within one year	**690**	98	**1,006**	98
In the second to fifth years, inclusive	**1,908**	392	**2,856**	392
After five years	**3,150**	196	**4,731**	196
	5,748	686	**8,593**	686

(b) As lessee

The Group leases certain production facilities and staff dormitories under operating lease arrangements. Leases for properties are negotiated for terms ranging from 2 to 10 years.

At 31 December 2005, the Group had total future minimum lease payments under non-cancellable operating leases falling due as follows:

	Group and Company	
	2005	2004
	RMB'000	RMB'000
Within one year	**516**	267
In the second to fifth years, inclusive	**1,304**	1,068
After five years	**1,499**	532
	3,319	1,867

31 December 2005

33. COMMITMENTS

In addition to the operating lease commitments detailed in note 32(b) above, the Group had the following commitments at the balance sheet date:

Capital commitments

	Group and Company	
	2005	2004
	RMB'000	RMB'000
Contracted, but not provided for:		
Land and buildings	**25,549**	37,144
Plant and machinery	**120,790**	90,640
Intangible assets	**—**	186
	146,339	127,970
Authorised, but not contracted for:		
Plant and machinery	**—**	43,750
	146,339	171,720

31 December 2005

34. RELATED PARTY TRANSACTIONS

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

	Notes	2005 RMB'000	2004 RMB'000
Purchases of raw materials:			
from a company in which a director of the Company is a shareholder	(i)	**623**	283
from another related party	(i)	**60,861**	30,820
		61,484	31,103
Sales of raw materials and goods:			
to a company in which a director of the Company is a shareholder	(ii)	**624**	244
to another related party	(ii)	**5,556**	656
		6,180	900
Subcontract income:			
from a company in which a director of the Company is a shareholder	(iii)	**258**	79
from other related parties	(iii)	**—**	295
		258	374
Subcontract fees:			
to a company in which a director of the Company is a shareholder	(iii)	**151**	422
to other related parties	(iii)	**474**	146
		625	568
Fixed assets transfers:			
from a company in which a director of the Company is a shareholder	(iv)	**805**	—
Rental income:			
from a company in which a director of the Company is a shareholder	(v)	**103**	98
from other related parties	(v)	**50**	—
		153	98
Rental expenses:			
to a company in which a director of the Company is a shareholder	(v)	**390**	267
Dividends:			
to a minority shareholder in which a director of the Company is a shareholder		**—**	4,559
to a controlling shareholder		**9,783**	5,590

31 December 2005

34. RELATED PARTY TRANSACTIONS *(continued)*

Notes:

(i) The purchases of raw materials were made at the fixed rates prescribed by relevant authorities of the PRC (if any). If no fixed rates are prescribed by the relevant authorities of the PRC, the purchase price will be negotiated and agreed by both parties with reference to the then prevailing market price, subject to adjustments.

(ii) The sales of raw materials and goods were made at the fixed rates prescribed by relevant authorities of the PRC (if any). If no fixed rates are prescribed by the relevant authorities of the PRC, the purchase price will be negotiated and agreed by both parties with reference to the then prevailing market price, subject to adjustments.

(iii) These transactions were conducted on the basis of rates mutually agreed between the related parties, which were set at cost incurred plus a margin of 5%.

(iv) The fixed assets transferred from a company in which a director of the Company is a shareholder included plant and machinery, which were transferred at their net book value amounts.

(v) The transactions were determined at rates mutually agreed between the related parties, which were lower than the market rates for properties of similar locations.

(b) Outstanding balances with related parties:

(i) Included in the balance due from related parties in the consolidated balance sheet at 31 December 2005 were advance to Weihai Baolong Special Petroleum Materials Co., Ltd. of RMB21,197,000 (2004: Nil) for purchases of casing billets and receivable of RMB780,000 from Maolong Machinery for its share of the issued share capital of Molong Asia.

(ii) Included in the balance due to related parties in the consolidated balance sheet at 31 December 2005 were payables of RMB2,274,000 (2004: Nil) to Maolong Machinery and RMB8,368,000 (2004: RMB138,000) to Shouguang Molong Electro-mechanical Equipment Company Limited.

The balances due from and to the related parties at 31 December 2005 are interest-free, unsecured and have no fixed payment terms.

(c) Compensation of key management personnel of the Group:

	2005 **RMB'000**	2004 RMB'000
Short term employee benefits	**1,219**	968
Post-employment benefits	**19**	17
Total compensation paid to key management personnel	**1,238**	985

Further details of directors' remuneration are included in note 8 to the financial statements.

The related party transactions above also constitute connected transactions or continuing connected transactions as defined in Chapter 20 of the GEM Listing Rules.

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35. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES

The Group's principal financial instruments comprise interest-bearing bank loans, cash and bank balances and pledged deposits. The main purpose of these financial instruments is to raise finance for the Group's operations. The Group has various other financial assets and liabilities such as trade receivables and trade payables, which arise directly from its operations.

It is, and has been, throughout the year under review, the Group's policy that no trading in financial instruments shall be undertaken.

The main risks arising from the Group's financial instruments are cash flow interest rate risk, foreign currency risk, credit risk and liquidity risk.

The Group does not have written risk management policies and guidelines. However, the management meets periodically to analyse and formulate measurements to manage the Group's exposure to financial risks. Generally, the Group employs a conservative strategy regarding its risk management.

(i) Cash flow interest rate risk

The interest rates and the terms of repayment of the Group's interest-bearing bank loans are disclosed in note 26 to the financial statements. The Group has no significant exposure to interest rate risk.

(ii) Foreign currency risk

The Group's exposure to market risk for changes in foreign currency exchange rates relates primarily to certain trade receivable and certain cash and cash equivalents in currencies other than the functional currency of RMB.

(iii) Credit risk

The Group trades mainly with recognised and creditworthy third parties. It is the Group's policy that all customers who wish to trade on credit terms are subject to credit verification procedures. In addition, receivable balances are monitored on an ongoing basis and the Group's exposure to bad debts is not significant. For transactions that are not denominated in the functional currencies of the relevant operating units, the Group does not offer credit terms without specific approval of the Head of Credit Control.

With respect to credit risk arising from the other financial assets of the Group, comprising cash and cash equivalents, available-for-sale financial assets and other receivables, the Group's exposure to credit risk arises from default of the other party, with a maximum exposure equal to the carrying amount of these instruments. There are no significant concentrations of credit risk within the Group in relation to the other financial assets.

Since the Group trades mainly with recognised and creditworthy third parties, there is no requirement for collateral.

(iv) Liquidity risk

The Group's objective is to maintain a balance between continuity of funding and flexibility through the use of interest-bearing bank loans.

31 December 2005

36. COMPARATIVE AMOUNTS

As further explained in notes 2.2 and 2.4 to the financial statements, due to the adoption of new HKFRSs during the current year, the accounting treatment and presentation of certain items and balances in the financial statements have been revised to comply with the new requirements. Accordingly, certain prior year and opening balance adjustments have been made and certain comparative amounts have been reclassified and restated to conform with the current year's presentation and accounting treatment.

37. APPROVAL OF THE FINANCIAL STATEMENTS

The financial statements were approved and authorised for issue by the board of directors of the Company on 19 March 2006.

NOTICE IS HEREBY GIVEN THAT the Annual General Meeting ("**AGM**") of Shandong Molong Petroleum Machinery Company Limited (the "**Company**", and together with its subsidiaries, the "**Group**") will be held at the meeting room, 5th Floor, No. 99 Beihai Road, Shouguang City, Shandong Province, The People's Republic of China on Friday, 12 May 2006 at 3:00 p.m. for the following purposes:

ORDINARY RESOLUTIONS

1. To receive, consider and, if thought fit, approve the report of the directors of the Company (the "**Directors**") for the year ended 31 December 2005;

2. To receive, consider and, if thought fit, approve the report of the supervisors of the Company (the "**Supervisors**") for the year ended 31 December 2005;

3. To receive and consider and, if thought fit, approve the audited consolidated financial statements and the report of the auditors for the year ended 31 December 2005;

4. To consider and approve the declaration by the board of Directors (the "**Board**") of a final dividend of RMB0.017 inclusive of tax per share of the Company for the year ended 31 December 2005, payable to shareholders of the Company whose names appear on the register of shareholders of the Company at the close of business on 11 April 2006, and to authorise the Directors to take any necessary actions required under the applicable laws and regulations in connection thereto;

5. To re-elect Mr. Wang Ping, Mr. Qin Xue Chang and Mr. Yan Yi Zhuang as Directors and to approve their remuneration;

6. To re-elect Ms. Li Bao Hui, Mr. Liu Wan Fu, and Mr. Fan Ren Yi as Supervisors and to approve their remuneration;

7. To consider and, if thought fit, approve the re-appointment of the international and PRC auditors of the Company for the year ending 31 December 2006 and to authorise the Board to fix their remuneration; and

8. To consider and, if thought fit, approve any motion proposed by any shareholders holding 5.0% of the shares of the Company with voting rights at the meeting, if any.

SPECIAL RESOLUTION

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

   THAT:

   (1) there be granted to the Board an unconditional general mandate ("**General Mandate**") to issue, allot and deal with additional shares in the capital of the Company (whether Domestic Shares or H Shares) and to make or grant offers or agreements in respect thereof, subject to the following conditions:

      (a) such mandate shall not extend beyond the Relevant Period save that the Board may during the Relevant Period make or grant offers or agreements which might require the exercise of such powers after the end of the Relevant Period;

(b) the aggregate nominal amount of shares allotted or agreed conditionally or unconditionally to be allotted (whether pursuant to an option or otherwise) by the Board otherwise than pursuant to any scrip dividends or similar arrangement providing for the allotment of such shares in lieu of the whole or part of a dividend on such shares or any share option scheme adopted by the Company and in accordance with the articles of association of the Company ("**Articles of Association**"), shall not exceed:

i. 20 per cent of the aggregate amount of Domestic Shares of the Company in issue; and

ii. 20 per cent of the aggregate nominal amount of H Shares of the Company in issue, in each case as at the date of passing of this resolution; and

(c) the Board will only exercise its power under such mandate in accordance with the Company Law of the PRC and the Rules Governing the Listing of Securities on the Growth Enterprise Market of The Stock Exchange of Hong Kong Limited (as the same may be amended from time to time) and only if all necessary approvals from the China Securities Regulatory Commission and/or other relevant PRC government authorities are obtained;

For the purposes of this resolution:

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

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

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

(a) the conclusion of the next annual general meeting of the Company following the passing of this resolution; or

(b) the expiry date of the 12-month period following the passing of this resolution; or

(c) the passing of a special resolution of the Company in a general meeting revoking or varying the authority set out in this resolution.

(2) contingent on the Board resolving to issue shares pursuant to paragraph (1) of this resolution, the Board be authorised:

(a) to approve, execute and do, or procure to be executed and done all such documents and matters which it may consider necessary in connection with the issue of such new shares, including but not limited to the time, quantity and place for such issue, to make all necessary applications to the relevant authorities, and to enter into underwriting agreement(s) or any other agreement(s);

(b) to determine the use of proceeds and to make necessary filings and registration with the relevant authorities in the PRC, and/or Hong Kong and any other places and jurisdictions (as appropriate);

(c) to increase the registered capital of the Company and make any amendments to the Articles of Association in accordance with such increase and to register the increased capital with the relevant authorities in the PRC and/or Hong Kong and any other places and jurisdictions (as appropriate) so as to reflect the new capital and/or share capital structure of the Company resulting from the intended allotment and issue of the shares of the Company pursuant to paragraph (1) of this resolution.

By order of the Board

Shandong Molong Petroleum Machinery Company Limited
Zhang En Rong
Chairman

Shandong, the PRC,
24 March 2006

Notes:

(A) The register of shareholders of the Company will be closed from 12 April 2006 to 12 May 2006 (both days inclusive) during which period no transfer of the Company's shares will be effected. Any holder of the shares of the Company whose name appears on the Company's register of shareholders of the Company at the close of business on 11 April 2006 and have completed the registration process will be entitled to attend and vote at the AGM. In order to qualify for the proposed final dividend, all transfers of shares accompanied by the relevant share certificates must be lodged with the Company's H share registrars in Hong Kong. Tricor Investor Services Limited, at 26/F., Tesbury Centre, No. 28 Queen's Road East, Hong Kong for registration no later than 4:00 p.m. on 11 April 2006.

(B) Shareholders who intend to attend the AGM should complete the reply slip and return it to the Company's H Shares registrar in Hong Kong, Tricor Investor Services Limited, at 26/F., Tesbury Centre, No. 28 Queen's Road East, Hong Kong (for H Shares) or to the registered office of the Company at No. 99, Beihai Road, Shouguang City, Shandong Province, The People's Republic of China (for Domestic Shares) on or before 21 April 2006.

(C) Any Shareholder entitled to attend and vote at the AGM is entitled to appoint in writing one or more persons as his proxy to attend and vote on his behalf. A proxy is not required to be a member of the Company. For shareholders appointing more than one proxy, the instrument(s) appointing each of proxies shall specify the class of number of shares represented by such proxies.

(D) In order to be valid, the instrument appointing a proxy shall be in writing under the hand of the appointer or his attorney duly authorised in writing or, if the appointer is a legal person, it shall be under seal or under the hand of a Director or attorney duly authorised.

(E) The instrument appointing a proxy shall be deposited to the Company's H Share registrar in Hong Kong (for H Shares), Tricor Investor Services Limited or the Company's registered office (for Domestic Shares) at the addresses as listed in Note (B) above not less than 24 hours before the time of holding of the AGM.

(F) Shareholders attending the AGM shall be responsible for their own transportation and accommodation expenses.

(G) The biographies of the re-elected Directors and Supervisors set out in this notice are disclosed in the annual report of the Company for the year ended 31 December 2005 in compliance with Rules 17.50(2) of the GEM Listing Rules.