



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)

2006

THIRD QUARTERLY REPORT

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This report for which the directors of Shandong Molong Petroleum Company Limited (the “Company”) collectively and individually accept full responsibility, includes particulars given in compliance with the Rules Governing the Listing of Securities on the GEM of the Stock Exchange (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.

HIGHLIGHTS

- Achieved a revenue of approximately RMB724,996,000 for the nine months ended 30 September 2006, which represents a growth of approximately 39.3% as compared to that of the same period last year.
- The net profit increased by approximately 49.3% to approximately RMB86,739,000, as compared to that of the same period last year.
- Earnings per share of the Group was approximately RMB13.4 cents for the nine months ended 30 September 2006.
- The board of directors of the Company does not recommend the payment of an interim dividend for the three months ended 30 September 2006.

The board (the "Board") of directors (the "Directors") of the Company is pleased to announce the unaudited results of Shandong Molong Petroleum Machinery Company Limited (the "Company") and its subsidiaries (collectively, the "Group") for the nine months ended 30 September 2006 (the "period under review").

UNAUDITED CONDENSED CONSOLIDATED PROFIT AND LOSS ACCOUNT

For the three months and nine months ended 30 September 2006

The unaudited results of the Group for the three months and nine months ended 30 September 2006 together with the unaudited comparative figures for the corresponding periods in 2005 are as follows:

	Note	Three months ended 30 September		Nine months ended 30 September	
		2006	2005	2006	2005
		RMB'000	RMB'000	RMB'000	RMB'000
Revenue	(2)	281,598	196,593	724,996	520,459
Cost of sales		(216,073)	(140,432)	(550,851)	(395,810)
Gross profit		65,525	56,161	174,145	124,649
Other income and gains		17,128	452	36,604	4,360
Selling and distribution costs		(7,328)	(5,797)	(20,470)	(15,137)
Administrative expenses		(8,674)	(6,621)	(23,367)	(16,888)
Other operating expenses		(19,682)	(3,117)	(39,254)	(4,730)
Profit from operating activities		46,969	41,078	127,658	92,254
Finance costs		(3,173)	(861)	(6,976)	(2,538)
Profit before tax		43,796	40,217	120,682	89,716
Taxation	(3)	(6,006)	(18,423)	(31,380)	(30,105)
Profit for the period		37,790	21,794	89,302	59,611
Attributable to:					
Shareholders of the Company		36,315	21,524	86,739	58,080
Minority interests		1,475	270	2,563	1,531
Earnings per share – basic (RMB cents)	(4)	5.6	3.3	13.4	9.7
Interim dividend per share (RMB cents)		N/A	N/A	1.5	2.0

NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Amounts expressed in Renminbi unless otherwise stated)

1. GENERAL INFORMATION AND BASIS OF PREPARATION

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

The Company was incorporated as a joint stock company with limited liability in the People's Republic of China (the "PRC") on 30 December 2001 and its H shares were listed on the GEM (the "Listing") on 15 April 2004. On 5 July 2004, the Company became a Sino-foreign joint stock limited company.

The unaudited financial statements of the Group have been prepared in accordance with Hong Kong Financial Reporting Standards ("HKFRSs") (which also include Hong Kong Accounting Standards ("HKAS") and Interpretations) issued by the Hong Kong Institute of Certified Public Accountants, accounting principles generally accepted in Hong Kong and the disclosure requirements of chapter 18 of the Rules Governing the Listing of Securities on the Growth Enterprise Market of the Stock Exchange of Hong Kong Limited (the "Stock Exchange") (the "GEM Listing Rules").

The principal accounting policies used in the preparation of the unaudited financial statements are consistent with those used in the preparation of the Group's annual financial statements for the year ended 31 December 2005.

The Group has adopted the following standards that have been issued and effective for the period beginning on or after 1 January 2006. The adoption of such standards did not have material effect on these financial statements.

HKAS 19 (Amendment)	Actuarial gains or losses, group plans and disclosures
HKAS 21 (Amendment)	Net Investment in a Foreign Operation
HKAS 39 (Amendment)	The Fair Value Option

The Group has not early adopted the following standards that have been issued but not yet effective. The adoption of such standards will not result in substantial changes to the Group's accounting policies.

HKAS 1 (Amendment)	Capital Disclosures
HKFRS 7	Financial Instruments – Disclosures

2. REVENUE AND SEGMENT INFORMATION

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

The Group's operating business is with customers based in the PRC, the United States, 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. Save as disclosed below, no further business segment information is presented as over 90% of the Group's revenue and assets relate to the sale of petroleum machinery.

	Three months ended 30 September 2006		Nine months ended 30 September 2006	
	RMB'000	2005 RMB'000	RMB'000	2005 RMB'000
PRC	204,287	152,485	509,531	374,747
United States	22,155	26,581	101,016	69,619
Europe	13,252	7,454	63,309	35,209
Other Countries	57,152	10,073	80,780	40,884
TOTAL	296,846	196,593	754,636	520,459

3. TAXATION

	Three months ended 30 September 2006		Nine months ended 30 September 2006	
	RMB'000	2005 RMB'000	RMB'000	2005 RMB'000
The charge comprises:				
PRC income tax	5,395	18,423	31,243	30,105
Deferred tax	611	—	137	—
	6,006	18,423	31,380	30,105

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

A subsidiary of the Company, namely, Weifang Molong Drilling Equipment Company Limited ("Molong Drilling Equipment") was approved by the Ministry of Civil Affairs of Shandong Province as a welfare enterprise and hence is entitled to a full exemption from corporate income tax. However, the exemption is only granted after the approval from the local tax administration. During the period under review, Molong Drilling Equipment has received the approval of full exemption from corporate income tax in 2006 from the local tax administration.

The Group has no significant unprovided deferred tax as at 30 September 2005 and 2006.

4. EARNINGS PER SHARE

The calculation of the basic earnings per share is based on the profit attributable to shareholders of approximately RMB36,315,000 and RMB86,739,000 for the three months and nine months ended 30 September 2006 (2005: RMB21,524,000 and RMB58,080,000) and on the weighted average number of approximately 647,998,000 shares (2005: 596,174,000 shares) in issue during the periods.

Diluted earnings per share is not presented for the three months and nine months ended 30 September 2005 and 2006 as there were no potential dilutive securities in existence during the relevant periods.

5. CAPITAL COMMITMENTS

	30 September 2006 (unaudited) RMB'000	31 December 2005 (audited) RMB'000
Contracted, but not provided for:		
Land and buildings	—	25,549
Plant and machinery	55,841	120,790
Intangible assets	—	—
	<hr/> 55,841	<hr/> 146,339
Authorised, but not contracted for:		
Plant and machinery	—	—
	<hr/> 55,841	<hr/> 146,339
	<hr/> <hr/> 55,841	<hr/> <hr/> 146,339

6. CONTINGENT LIABILITIES

As at 30 September 2006, the Group did not have any significant contingent liabilities.

7. GEARING RATIO

As at 30 September 2006, the Group's gearing ratio was approximately 65.4% (31 December 2005: 56.7%) which is calculated based on the Group's total liabilities of approximately RMB972,640,000 (31 December 2005: approximately RMB544,100,000) and total assets of approximately RMB1,488,040,000 (31 December 2005: approximately RMB959,129,000).

8. FOREIGN EXCHANGE EXPOSURE

For the nine months ended 30 September 2006, approximately 32.5% of the Group's operating revenue is denominated in US dollars and the rest are denominated in RMB. The cost of sales and capital of the Group are mainly denominated in RMB. The official exchange rate between US dollars and RMB has generally been stable in recent years. The Directors consider that the Group's exposure to fluctuation in foreign exchange rate was minimal and, accordingly, the Group did not employ any financial instruments for hedging purposes.

9. INTERIM DIVIDEND

The Board does not recommend the payment of an interim dividend for the three months ended 30 September 2006 (2005: Nil).

MANAGEMENT DISCUSSION AND ANALYSIS

Financial Review

The Group has achieved a satisfactory result during the period under review. For the nine months ended 30 September 2006, the Group recorded an unaudited revenue of approximately RMB724,996,000 (2005: RMB520,459,000) and an unaudited net profit of approximately RMB86,739,000 (2005: RMB58,080,000). Compared to the corresponding period in the previous year, the revenue has a growth of approximately RMB204,537,000 or 39.3%, and the net profit has a growth of approximately RMB28,659,000 or 49.3%.

For the three months ended 30 September 2006, the Group recorded an unaudited revenue of approximately RMB281,598,000 (2005: RMB196,593,000) and an unaudited net profit of approximately RMB36,315,000 (2005: RMB21,524,000). Compared to the corresponding period in the previous year, the revenue has a growth of RMB85,005,000 or 43.2%, and the net profit has a growth of RMB14,791,000 or 68.7%.

Business Review

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

During the period under review, the Group continued to strengthen its research and development capabilities, actively improve the quality of existing products and expand its sales network. Along with the Group's excellent quality products and services, the competitiveness of the Group's products was further enhanced, resulting in the increase in domestic and overseas sales volume and the significant growth in revenue and profits.

The sales income of the Group's products derived from China market represented 67.5% of the total sales during the period under review. The Group's domestic customers are still mainly oil fields operated by PetroChina Company Limited and its subsidiaries (collectively "PetroChina Group"), including Changqing Oil Field (長慶油田), Liaohe Oil Field (遼河油田), Daqing Oil Field (大慶油田), Xinjiang Oil Field (新疆油田), Qinghai Oil Field (青海油田), Huabei Oil Field (華北油田) and Jilin Oil Field (吉林油田); and those operated by China Petroleum & Chemical Corporation and its subsidiaries (collectively "Sinopec Group"), including Shengli Oil Field (勝利油田), Zhongyuan Oil Field (中原油田) and Jiangnan Oil Field (江漢油田). As for foreign sales, the total sales from overseas customers increased to RMB245,105,000, representing approximately 32.5% of the total sales of the Group. The overseas customers were mainly distributed in countries and regions such as North America, the United Kingdom, Russia, Indonesia, Middle East, Brunei, Egypt and Syria. The trading volumes between the Group and the above customers recorded different growth in the period under review.

Proposed Listing on the Main Board by way of introduction

The Company proposes to list its H shares on the Main Board by way of introduction. The listing of H shares of the Company on the Main Board will attract institutional, professional and public investors, which will further enhance the profile of the Group and the liquidity and recognition of its shares. In addition, the Directors considers that listing on the Main Board will be beneficial to the Group's future growth, financial flexibility and business development.

Outlook

Looking forward, with the continuous growth of global economy, demand for crude oil in both domestic and overseas markets will grow steadily. Demand for petroleum drilling and extraction machinery products will maintain a sustainable growth correspondingly, providing significant opportunities for development of petroleum machinery manufacturers. The Group is highly confident in the future development of the petroleum machinery industry.

The Group will further enhance its competitiveness to increase market share and enhance the corporate profile in the industry through various strategies, including strengthening its research and development capability, enhancement of domestic and overseas market extension, and enlarging production capacity.

Strengthening Research and Development Capability

The Group dedicates in the optimisation of the functions and quality of existing products and conducts innovation of new products. At the same time, recruitment of more industrial experts and collection of the latest industrial information and technology are continued by the Group, so as to maintain its technologically leading position in the industry.

Exploration of Overseas and Domestic Markets

In respect of the domestic market, based on the good relationship with the existing customers, the Group will further enhance its strength of locating its four largest sales branches in Dongbei, Huabei, Xibei, and Huazhong that enables the Group to visit its clients regularly, in order to collect their opinions and the latest market information so as to strengthen the quality of pre-sales and after-sales services as well as to increase the purchasing volume of existing customers, and gain more market share in the PRC.

In respect of the overseas market, with the Group's successful exploration of new markets in Russia, Canada and United Arab Emirates, the Group will continue to conduct research and analyse other emerging overseas markets, improve the contents of the Group's official web-site continuously, actively introduce new products and finally increase the percentage of the overseas sales of the Group's products.

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Capacity Enhancement

Since the expected domestic and oversea petroleum and natural gas exploration and production capital will increase continuously, petroleum drilling and extraction machinery industry will obtain continuing development. Trial production of the Group's oil casing production line with an annual capacity of 250,000 tons commenced smoothly. And with main equipments and processes reaching the design requirement, production line will commence operation at the expected date, that will further increase the Group's production capability.

Besides the regular production with existing equipments, the Group will enhance its production efficiency and capacity by upgrading internal operation, such as organizing purchase order, optimizing production flow, and improving personnel skill.

MATERIAL ACQUISITION/DISPOSAL AND SIGNIFICANT INVESTMENT

During the period under review, the Group had no material acquisition or disposal and significant investments.

BANK FACILITIES AND PLEDGE OF ASSETS

As at 30 September 2006, the Group had bank credit loans amounting to RMB208,000,000. In addition, six banks, including the Agricultural Bank of China (Shandong Branch), have granted credit facilities amounting to RMB440,000,000 to the Group. None of these credit facilities have been utilized.

EMPLOYEES

For the period under review, the breakdown of the number of employees of the Group is set out below:

	Nine months ended	
	30 September	
	2006	2005
Research and development	57	49
Production	1,353	1,270
Quality control	92	89
Sales and marketing	63	52
Administration	168	168
Total	<u>1,733</u>	<u>1,628</u>

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

MODEL CODE FOR SECURITIES TRANSACTION BY DIRECTORS

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

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

As at 30 September 2006, the interest and short positions of the Directors, supervisors (the "Supervisors") and chief executives of the Company in the shares, debentures or underlying shares of the Company or any of its associated corporations (within the meaning of Part XV of the Securities, and Futures Ordinance (the "SFO")), which will be required to be notified to the Company and the Stock Exchange pursuant to Divisions 7 and 8 of Part XV of the SFO (including interests or short positions which they are taken or deemed to have under such provisions of the SFO) or which will be required, pursuant to section 352 of the SFO, to be entered in the register referred to therein, or which will be required pursuant to rules 5.46 to 5.68 of the GEM Listing Rules, to be notified to the Company and the Stock Exchange, will be as follows:

Long positions in shares of the Company

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 of the Company had any interests or short position in the shares, underlying shares or debentures of the Company or any of its associated corporations (within the meaning of Part XV of the SFO), will have to be notified to the Company and the Stock Exchange under Divisions 7 and 8 of Part XV of the SFO (including interests and short positions which they are taken or deemed to have under the SFO) or will be required pursuant to the required standard of dealings by Directors as referred to in Rule 5.46 to 5.48 of the GEM Listing Rules or section 352 the SFO to be entered in the register of interests reserved to therein.

DIRECTORS' AND SUPERVISORS' RIGHTS TO ACQUIRE SHARES OR DEBENTURES

None of the Directors or Supervisors or their respective associates (as defined under the GEM Listing Rules) was granted by the Company or its subsidiaries any rights or options to acquire any shares in or debentures of the Company or had exercised any such rights as at 30 September 2006.

SHARE OPTION SCHEME

The Company does not have any share option scheme.

SUBSTANTIAL SHAREHOLDERS

As at 30 September 2006, so far as the Directors are aware, the following persons (other than Directors, Supervisors or chief executive of the Company) had interests or short positions in the shares and underlying shares and debentures of the Company which would fall to be disclosed to the Company under the provisions of Divisions 2 and 3 of Part XV of the SFO and required to be recorded in the register to be kept under section 336 of the SFO:

Long positions in shares

Name	Type of interests	Number of shares	Percentage of domestic shares	Percentage of H shares	Percentage of total registered capital
Zhang Xiu Lan (Note 1)	Interests of spouse	279,517,000	69.58%	—	43.14%
Li Xiu Fen (Note 2)	Interests of spouse	34,216,000	8.52%	—	5.28%
Zhang Xin Lan (Note 3)	Interests of spouse	30,608,000	7.62%	—	4.72%
Li Bao Hui (Note 4)	Interests of spouse	21,410,000	5.33%	—	3.30%
Paul G. Desmarais (Note 5)	Interests of controlled corporation	69,000,000	—	28.02%	10.65%
Gelco Enterprises Ltd (Note 5)	Interests of controlled corporation	69,000,000	—	28.02%	10.65%
Power Corporation of Canada (Note 5)	Interests of controlled corporation	69,000,000	—	28.02%	10.65%
Power Financial Corporation (Note 5)	Interests of controlled corporation	69,000,000	—	28.02%	10.65%
IGM Financial Inc. (Note 5)	Interests of controlled corporation	69,000,000	—	28.02%	10.65%
RAB Energy Fund Limited (Note 5)	Investment Manager	33,832,000	—	13.74%	5.22%
Commonwealth Bank of Australia (Note 5)	Corporate interest controlled by the significant shareholder	19,718,000	—	8.01%	3.04%
Martin Currie Investment Management Limited (Note 5)	Investments of controlled corporation	12,400,000	—	5.04%	1.91%
China Development Capital Partnership L.P.	Beneficial owner	12,400,000	—	5.04%	1.91%

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

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

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

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

Note 5: Interests in H shares.

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

COMPETING INTERESTS

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

COMPLIANCE ADVISER'S INTEREST

As updated and notified by the Company's compliance adviser, Deloitte & Touche Corporate Finance Limited (the "Compliance Adviser"), neither the Compliance Adviser, nor its directors, employees or associates (as defined under the GEM Listing Rules) had any interest in the share capital of the Company as at 30 September 2006 pursuant to Rule 6.36 of the GEM Listing Rules.

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

PURCHASE, SALE OR REDEMPTION OF SECURITIES

Neither the Company nor its subsidiary has purchased, sold or redeemed any listed securities of the Company during the nine months ended 30 September 2006.

AUDIT COMMITTEE

The Company set up an audit committee on 20 March 2004, and has made amendments to its written terms of reference on 18 January 2005 in compliance with the provisions as set out in Rules C.3.1 to C.3.3 of the “Code on Corporate Governance Practices” set out in Appendix 15 of the GEM Listing Rules. The primary duty of the Audit Committee is to review and supervise external auditors, financial information, financial reporting system and internal control procedures. The Audit Committee is comprised of three independent non-executive Directors, namely Mr. Qin Xue Chang, Mr. Yan Yi Zhuang and Mr. Loke Yu alias Loke Hoi Lam. Mr. Qin Xue Chang is the chairman of the Audit Committee. The Audit Committee has discussed with the management in respect of accounting principles and practices adopted by the Group, internal control and financial reporting matters, including review of the unaudited results for the three months ended 30 September 2006.

DIRECTORS

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

By order of the Board of Directors

Zhang En Rong

Chairman

Shandong, the PRC
8 November 2006