Honghua Group Limited
宏華集團有限公司

(a company incorporated in the Cayman Islands with limited liability)

(Stock code: 0196)

ANNOUNCEMENT OF INTERIM RESULTS FOR THE SIX MONTHS ENDED 30 JUNE 2008

FINANCIAL HIGHLIGHT

Honghua Group Limited (the "company" or "Honghua Group") listed on the Main Board of The Stock Exchange of Hong Kong Limited on 7 March 2008:

	Six months ended 30 June		
	2008	2007	% change
	(Unaudited)	(Unaudited)	
Revenue *(RMB'000)*	**1,502,861**	1,222,056	23.0%
Gross profit *(RMB'000)*	**445,643**	398,218	11.9%
Gross profit margin *(%)*	**29.7**	32.6	
Profits from operations *(RMB'000)*	**214,293**	272,845	-21.5%
Earnings attributable to equity shareholders of the company *(RMB'000)*	**125,945**	185,891	-32.2%
Basic earnings per share *(RMB cents)*	**4.16**	7.44	-44.1%

No interim dividend was declared for the six months ended 30 June 2008. A special dividend was declared after the interim period of Hong Kong Dollars 10 cents per share.

INTERIM RESULTS

The board (the "Board") of directors of Honghua Group is pleased to announce the unaudited interim financial results of the company and its subsidiaries (collectively, the "Group") for the six months ended 30 June 2008 (the "period"), together with the comparative figures for the corresponding period in 2007. The interim financial report for the six months ended 30 June 2008 is unaudited, but has been reviewed by KPMG, in accordance with Hong Kong Standard on Review Engagements 2410 "Review of interim financial information performed by the independent auditor of the entity", issued by the Hong Kong Institute of Certified Public Accountants whose unmodified review report is included in the interim financial report to be sent to shareholders. These interim results have also been reviewed by the company's audit committee, comprising solely the independent non-executive directors (the "Director's"), one of whom chairs the committee.

CONSOLIDATED INCOME STATEMENT

For the six months ended 30 June 2008

(Expressed in Renminbi ("RMB"))

		Six months ended 30 June	
		2008	2007
	Note	***RMB'000***	*RMB'000*
		(Unaudited)	*(Unaudited)*
Revenue		**1,502,861**	1,222,056
Cost of sales		**(1,057,218)**	(823,838)
Gross profit		**445,643**	398,218
Other operating revenue		**1,637**	2,768
Other operating expenses		**(631)**	(59)
Selling expenses		**(123,733)**	(71,576)
General and administrative expenses		**(113,339)**	(59,874)
Other net income		**4,716**	3,368
Profit from operations		**214,293**	272,845
Net finance costs	4(a)	**(74,242)**	(10,573)
Share of profits from a jointly controlled entity		**10,822**	—
Profit before taxation		**150,873**	262,272
Income tax expenses	5	**(24,965)**	(41,564)
Profit for the period		**125,908**	220,708
Attributable to:			
Equity shareholders of the company		**125,945**	185,891
Minority interests		**(37)**	34,817
Profit for the period		**125,908**	220,708
Earnings per share — basic (RMB cents)	7	**4.16**	7.44

CONSOLIDATED BALANCE SHEET

At 30 June 2008
(Expressed in RMB)

	Note	**30 June 2008 RMB'000 (Unaudited)**	31 December 2007 RMB'000 (Audited)
Non-current assets			
Fixed assets			
— Property, plant and equipment		**286,104**	259,453
— Interests in leasehold land held for own use under operating leases		**55,123**	54,830
— Freehold land		**5,530**	5,880
		346,757	320,163
Deposit paid for acquisition of leasehold land		**57,612**	28,513
Construction in progress		**75,293**	38,741
Intangible assets		**367,371**	389,691
Interest in a jointly controlled entity		**46,917**	6,006
Deferred tax assets		**5,866**	11,837
Total non-current assets		**899,816**	794,951
Current assets			
Inventories	8	**1,468,745**	1,031,768
Trade and other receivables	9	**1,408,585**	1,606,960
Amounts due from related companies		**4,715**	40,798
Amount due from immediate holding company		**13,118**	—
Pledged bank deposits		**241,167**	261,109
Time deposits		**1,535,713**	—
Cash and cash equivalents		**1,072,441**	195,367
Total current assets		**5,744,484**	3,136,002
Total assets		**6,644,300**	3,930,953

CONSOLIDATED BALANCE SHEET

At 30 June 2008

(Expressed in RMB)

	Note	**30 June 2008** *RMB'000* **(Unaudited)**	31 December 2007 *RMB'000* (Audited)
Current liabilities			
Interest-bearing borrowings		**805,368**	856,059
Amounts due to related companies		**89,757**	46,490
Loan from immediate holding company		**—**	405,488
Loans from shareholders of the ultimate holding company		**—**	76,850
Trade and other payables	10	**1,195,833**	1,136,892
Current taxation		**18,112**	33,777
Total current liabilities		**2,109,070**	2,555,556
Net current assets		**3,635,414**	580,446
Total assets less current liabilities		**4,535,230**	1,375,397
Non-current liabilities			
Interest-bearing borrowings		**14,612**	15,703
Deferred tax liabilities		**5,339**	3,983
Total non-current liabilities		**19,951**	19,686
Total liabilities		**2,129,021**	2,575,242
Equity			
Share capital		**309,232**	233,155
Reserves		**4,142,432**	1,054,348
Total equity attributable to equity shareholders of the company		**4,451,664**	1,287,503
Minority interests		**63,615**	68,208
Total equity		**4,515,279**	1,355,711
Total liabilities and equity		**6,644,300**	3,930,953

1. GENERAL INFORMATION AND GROUP REORGANISATION

The company was incorporated in the Cayman Islands on 15 June 2007 as an exempted company with limited liability under the Companies Law, Cap 22 (Law 3 of 1961, as consolidated and revised) of the Cayman Islands.

The unaudited interim financial report for the six months ended 30 June 2008 comprise the Group and the Group's interest in a jointly controlled entity.

The companies comprising the Group underwent reorganisation (the "Reorganisation") which involved a series of equity transactions in connection with the company's acquisition of equity interest in Sichuan Honghua Petroleum Equipment Co., Ltd ("Honghua Company") and its subsidiaries, to rationalise the Group's structure in preparation for the listing of the company's shares on the Main Board of The Stock Exchange of Hong Kong Limited (the "Stock Exchange"). Details of the Reorganisation are set out in the prospectus of the company dated 25 February 2008 ("Prospectus"). The company's shares were listed on the Stock Exchange on 7 March 2008 (the "Listing Date").

The Group is regarded as a continuing entity resulting from the Reorganisation under common control. The unaudited interim financial report has been prepared on the basis that the company was the holding company of the Group for both periods presented, rather than from the date of the Reorganisation. Accordingly, the results of the Group for the six months ended 30 June 2007 and 2008, respectively, include the results of the company and its subsidiaries since their respective dates of incorporation or at the date that common control was established, if later, as if the current group structure had been in existence throughout the two periods presented.

2. BASIS OF PREPARATION

This unaudited interim financial report has been prepared in accordance with the applicable disclosure provisions of the Rules Governing The Listing of Securities on The Stock Exchange of Hong Kong Limited, including compliance with International Accounting Standard ("IAS") 34 "Interim financial reporting" promulgated by the International Accounting Standards Board ("IASB").

The unaudited interim financial report has been prepared in accordance with the same accounting policies adopted in the 2007 annual financial statements.

3. SEGMENT REPORTING

Segment information is presented in respect of the Group's business segments. Business segment information is chosen as the primary reporting format because this is more relevant to the Group's internal financial reporting system. Inter-segment pricing is determined on an arm's length basis.

Business segments

The Group consists of the following main business segments:

Drilling rigs — Manufacture and sale of drilling rigs

Parts and components — Manufacture and sale of parts and components of drilling rigs

	Six months ended 30 June 2008 (Unaudited)			
	Drilling rigs	**Parts and components**	**Eliminations**	**Total**
	RMB'000	***RMB'000***	***RMB'000***	***RMB'000***
Revenue	**1,361,932**	**514,401**	**(373,472)**	**1,502,861**
Cost of sales	**(958,952)**	**(431,358)**	**333,092**	**(1,057,218)**
Other income and expenses	**(172,296)**	**(59,079)**	**—**	**(231,375)**
Segment result	**230,684**	**23,964**	**(40,380)**	**214,268**
Unallocated				**25**
Net finance costs				**(74,242)**
Share of profits from a jointly controlled entity				**10,822**
Income tax expenses				**(24,965)**
Profit for the period				**125,908**

	Six months ended 30 June 2007 (Unaudited)			
	Drilling rigs	Parts and components	Eliminations	Total
	RMB'000	*RMB'000*	*RMB'000*	*RMB'000*
Revenue	1,073,373	760,174	(611,491)	1,222,056
Cost of sales	(724,003)	(557,163)	457,328	(823,838)
Other income and expenses	(69,637)	(57,794)	—	(127,431)
Segment result	279,733	145,217	(154,163)	270,787
Unallocated				2,058
Net finance costs				(10,573)
Income tax expenses				(41,564)
Profit for the period				220,708

4. PROFIT BEFORE TAXATION

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

	Six months ended 30 June	
	2008	2007
	RMB'000	*RMB'000*
	(Unaudited)	(Unaudited)
(a) Net finance costs		
Exchange loss/(gain), net	**55,719**	(1,305)
Interest income	**(17,218)**	(2,795)
Interest on bank borrowings wholly repayable within five years	**32,309**	13,859
Bank charges	**3,432**	814
	74,242	10,573
(b) Other items		
Amortisation and depreciation		
— assets held for use under operating leases	**760**	402
— other assets	**15,534**	11,091
Operating lease charges in respect of properties	**1,522**	541
Provision for product warranty	**3,472**	8,225
Research and development costs (note)	**13,309**	9,646

Note: Research and development costs included staff costs of employees in the Research and Development Department.

5. INCOME TAX IN THE CONSOLIDATED INCOME STATEMENT

(a) *Taxation in the consolidated income statement represents:*

	Six months ended 30 June	
	2008	2007
	RMB'000	*RMB'000*
	(Unaudited)	(Unaudited)
Current tax — the People's Republic of China ("PRC") enterprise income tax		
Provision for the period	**18,111**	49,312
Over-provision in respect of prior years	**(711)**	—
	17,400	49,312
Deferred tax		
Origination and reversal of temporary differences	**7,565**	(7,748)
	24,965	41,564

(i) Hong Kong Profits Tax

No provision for Hong Kong Profits Tax has been made as the Group did not have assessable profits subject to Hong Kong Profits Tax for the period (2007: Nil).

(ii) Cayman Islands

The company was incorporated in the Cayman Islands as an exempted company with limited liability under the Companies Law of the Cayman Islands and accordingly, is exempt from the payment of the Cayman Islands income tax.

(iii) British Virgin Islands

Pursuant to the rules and regulations of the British Virgin Islands, the Group is not subject to any tax in the British Virgin Islands.

(iv) United States of America

Taxation for Honghua America, LLC. is charged at the appropriate current rates of taxation ruling in the relevant state.

(v) United Arab Emirates

Honghua Golden Coast Equipment FZE is not subject to income tax in accordance with the relevant United Arab Emirates income tax laws and regulations.

(vi) PRC enterprise income tax

In accordance with the relevant PRC income tax laws and regulations, the applicable income tax rates of the company's subsidiaries are as follows:

(a) Honghua Company

On 15 September 2006, Honghua Company changed from being a domestic enterprise to a wholly owned foreign invested enterprise, and was entitled to tax concessions from 1 October 2006 whereby the profit for the first two financial years commencing on the profit-making year (after netting off tax losses carried forward from prior years) was exempt from national income tax in the PRC and the profit for each of the subsequent three financial years was taxed at 50% of the prevailing tax rate set by the relevant authorities.

All income earned from 1 January 2007 to 30 June 2007 are exempt from national income tax. Honghua Company was still subject to a local income tax at a rate of 3%.

On 16 March 2007, the Fifth Plenary Session of the Tenth National People's Congress passed the Corporate Income Tax Law of the PRC ("New Tax Law") which took effect on 1 January 2008 and the income tax rate was reduced from 33% to 25%. The State Council of the PRC passed an implementation guidance note on 26 December 2007, which sets out details of how existing preferential income tax rates will be adjusted to the standard rate of 25%.

All income earned from 1 January 2008 to 30 June 2008 are subject to 50% of the prevailing tax rate of 25%.

(b) Chengdu Hongtian Electric Drive Engineering Co., Ltd ("Hongtian Company") and Sichuan Honghua Youxin Petroleum Machinery Co., Ltd ("Youxin Company")

Hongtian Company and Youxin Company are recognised as entities established in the western regions of the PRC with principal revenue of over 70% generated from the encouraged business activities. Pursuant to the approvals obtained from the relevant PRC tax authorities, the companies are entitled to a preferential income tax rate of 15%.

(c) Honghua International Co., Ltd ("Honghua International")

Pursuant to the income tax rules and regulations of the PRC, the income tax rate applicable to Honghua International is 25% (2007: 33%).

(d) Sichuan Honglian Industrial Co., Ltd and Sichuan Hongcheng Business Trading Co., Ltd

Sichuan Honglian Industrial Co., Ltd and Sichuan Hongcheng Business Trading Co., Ltd were incorporated on 30 April 2008 and 25 April 2008 respectively. There were no assessable profits for the period ended 30 June 2008.

(b) Withholding tax

Further under the New Tax Law, from 1 January 2008 onwards, non-resident enterprises without an establishment or place of business in the PRC or which have an establishment or place of business in the PRC but whose relevant income is not effectively connected with the establishment or a place of business in the PRC, will be subject to withholding tax at the rate of 10% (unless reduced by treaty) on various types of passive income such as dividends derived from sources in the PRC. As the Group's foreign-invested enterprise is directly held by a Hong Kong incorporated company, a rate of 5% is applicable to the calculation of this withholding tax. The Caishui (2008) No.1 approved by the Minister of Finance and State Administration of Tax on 22 February 2008 exempts the dividend distribution out of pre-2008 retained earnings of foreign investment enterprises from withholding tax. Accordingly, the retained profits as at 31 December 2007 in the Group's foreign-invested enterprises' bonds and records will not be subject to 5% withholding tax on future distribution. Deferred tax liabilities have been provided for in this regard based on the expected dividends to be distributed from the company's subsidiaries in the PRC in the foreseeable future in respect of the profits generated after 31 December 2007.

6. DIVIDENDS

	2008 ***RMB'000*** **(Unaudited)**	2007 *RMB'000* (Unaudited)
Special dividend declared after the interim period of Hong Kong Dollars ("HKD") 10 cents per share (2007: HKD nil)	**290,236**	—

The special dividend has not been recognised as a liability at the balance sheet date.

7. EARNINGS PER SHARE

The calculation of basic earnings per share for the six months ended 30 June 2008 is based on the profit attributable to equity holders of the company for the period and the weighted average number of ordinary shares of 3,031,152,527.

Pursuant to a group reorganisation on 16 October 2007, the company acquired all shareholdings of Asia Harbour International Limited and became the holding company of the Group. As at 16 October 2007, the company has issued 2,500,000,000 shares at par value of HK$0.1 each. The calculation of basic earnings per share for the six months ended 30 June 2007 is based on the profit attributable to equity shareholders of the company for the period and on the assumption that 2,500,000,000 shares in issue as at the date the company became the holding company of the Group were outstanding throughout the entire period.

The diluted earnings per share for the six months ended 30 June 2008 and 2007 are the same as the basic earnings per share has been made as there were no potential dilutive ordinary shares outstanding during that period.

8. INVENTORIES

	30 June 2008 *RMB'000* **(Unaudited)**	31 December 2007 *RMB'000* (Audited)
Raw materials	**387,449**	244,290
Work in progress	**478,555**	369,477
Finished goods	**279,134**	368,868
Goods in transit	**323,607**	49,133
	1,468,745	1,031,768

An analysis of the amount of inventories recognised as an expense is as follows:

	Six months ended 30 June	
	2008 *RMB'000* **(Unaudited)**	2007 *RMB'000* (Audited)
Carrying amount of inventories sold	**1,072,939**	790,220
Write-down of inventories	**3,524**	25,393
Reversal of write-down of inventories	**(22,717)**	—
	1,053,746	815,613

9. TRADE AND OTHER RECEIVABLES

	30 June 2008	31 December 2007
	RMB'000	*RMB'000*
	(Unaudited)	(Audited)
Trade receivables	**735,418**	1,113,964
Bills receivable	**63,202**	57,663
Less: allowance for doubtful debts *(note 9(b))*	**(3,312)**	(3,312)
Sub-total	**795,308**	1,168,315
Value-added tax receivable	**123,243**	129,372
Other receivables	**84,284**	55,944
Prepayments	**405,750**	253,329
	1,408,585	1,606,960

(a) Ageing analysis:

Included in trade and other receivables are trade receivables and bills receivable (net of impairment losses) with the following ageing analysis as of the balance sheet date:

	30 June 2008	31 December 2007
	RMB'000	*RMB'000*
	(Unaudited)	(Audited)
Current	**472,853**	964,933
Less than 1 month past due	**61,761**	78,828
1 to 3 months past due	**197,615**	80,515
More than 3 months but less than 12 months past due	**63,079**	44,039
	795,308	1,168,315

The Group normally grants an average credit period of 30 to 90 days to its trade customers.

(b) Impairment of trade receivables and bills receivable

Impairment losses in respect of trade receivables and bills receivable are recorded using an allowance account unless the Group is satisfied that recovery of the amount is remote, in which case the impairment loss is written off against trade receivables and bills receivable directly.

The movement in the allowance for doubtful debts during the period/year, including both specific loss components, is as follows:

	2008	2007
	RMB'000	*RMB'000*
	(Unaudited)	(Audited)
At 1 January	**3,312**	3,551
Write-back of provision for impairment losses	**—**	(239)
At 30 June/31 December *(Note 9)*	**3,312**	3,312

The individually impaired receivables relate to customers that are in financial difficulties and management assesses the recoverability is remote. Consequently, specific allowances for doubtful debts were recognised. The Group does not hold any collateral over these balances.

10. TRADE AND OTHER PAYABLES

	30 June	31 December
	2008	2007
	RMB'000	*RMB'000*
	(Unaudited)	(Audited)
Trade payables	**586,027**	600,089
Bills payable	**259,438**	135,890
Receipts in advance	**250,328**	226,368
Other payables	**100,040**	174,545
	1,195,833	1,136,892

Included in trade and other payables are trade and bills payable with the following ageing analysis as of the balance sheet date:

	30 June	31 December
	2008	2007
	RMB'000	*RMB'000*
	(Unaudited)	(Audited)
Within 3 months	**609,554**	535,768
3 months to 6 months	**159,531**	107,873
6 months to 1 year	**46,562**	63,294
Over 1 year	**29,818**	29,044
	845,465	735,979

MANAGEMENT DISCUSSION AND ANALYSIS

Industry Review

In recent years, the rapid global development of the drilling platform industry has persistently driven up the demand for drilling rig products. In the past five years (2002–2007), the compound annual growth rate ("CAGR") representing a compound of capital expenditure on drilling industry and the number of drilling wells reached 22% and 11%, respectively.

With the rate of global economic development, it is expected that the world's reliance on oil will continue for the next 20 to 30 years or beyond. According to a forecast by the International Energy Agency, worldwide crude oil expenditure will continue to rise. It estimated that demand will reach 118 million barrels per day in 2030, as compared to 84 million barrels per day in 2005, representing a CAGR of 1.4%. The global demand for oil exploitation remained strong. Recently, the United States, China and Russia introduced policies to promote oil exploration and production. As a result, these policies have propelled the demand of drilling rigs in the North American market, where land drilling rigs constitute a relatively large proportion as well as the important emerging markets, such as China and Russia.

Business Review

Operations Review

Honghua Group is a leading manufacturer of land drilling rigs in China, with a focus on production and sales of land drilling rigs and related rig parts and components; as well as the provision of technical support services to customers. In addition to drilling rigs, we also offer rig parts and components used for newly-built and refurbished drilling rigs to customers, allowing us to become a one-stop solution provider. By using an offshore drilling module approach, we are also engaged in the production and sales of parts and components for offshore rigs.

Prior to procurement of drilling equipment, it is the usual practice for both domestic and foreign oil companies at the beginning of the year, or at the end of the previous year, to develop a budget for the annual capital expenditure used on exploration, exploitation and production. As the production lead time for drilling rigs is normally between six to nine months, the Group's revenue for the provision of drilling rigs and rig parts and components is usually recognised in the second half of the year. During the Period, the earthquakes in Sichuan adversely affected transportation arrangements which in turn to a delay in the delivery of drilling rigs.

Land Drilling Rigs Business

During the Period, revenue from sales of land drilling rigs amounted to approximately RMB1,362 million, representing an increase of approximately 26.9% as compared to approximately RMB1,073 million in the corresponding period last year, contributing approximately 90.6% to total revenue of the Group.

Products of the Group comprise digitally-controlled land rigs and conventional land rigs. During the Period, total sales of drilling rigs amounted to 31 units, among which 17 units were digitally-controlled land rigs, a decrease of 13 units as compared to the corresponding period last year, and 14 units were conventional land rigs, an increase of 2 units as compared to the corresponding period last year. This was mainly due to the sales decrease in the North American market.

The Group's drilling rig products have already reached a drilling capability of 9,000 metres. During the Period, the Group sold 1 unit of 9,000 metre heavy drilling rig, 11 units of 7,000 metre heavy drilling rigs and 11 units of 5,000-metre mid-level drilling rigs. The sales volume for 4,000-metre mid-level drilling rigs, and 2,000-metre light drilling rigs were 6 and 2 units respectively.

During the Period, the Group proactively expanded exports, resulting in a slight drop in revenue contribution from China to 12.0%. The Group sold 9 units of drilling rigs to the domestic market during the Period, representing a decrease of 14 units as compared to 23 units in the corresponding period last year. Exports represented 88.0% contribution to the Group's total revenue. The Group mainly focused on exporting to the Russian market. The Group sold 12 units of drilling rigs to Russia as compared to 3 units in the corresponding period last year. The sales volumes in other markets were evenly distributed, among which 2 units of drilling rigs were sold to the North American market, 2 units of drilling rigs were sold to the South East Asian market and 6 units of drilling rigs were sold to the South Asian market.

Rig Parts and Components Business

During the Period, revenue from sales of rig parts and components amounted to RMB141 million, representing a decrease of approximately 5.4% as compared to RMB149 million in the same period of 2007, contributing approximately 9.4% to the total revenue of the Group.

Our products include mud pumps and other parts and components. During the Period, sales of mud pumps amounted to 32 units, representing a fall of 28 units as compared to 60 units in the corresponding period last year. Revenue from sales of mud pump products amounted to RMB29 million, representing a decrease of RMB41 million as compared to the corresponding period last year. The decline was mainly due to the decrease in the number of mud pumps sales contracts and the slight decline in the selling price of mud pumps. Sales of other parts and components achieved stable growth. During the Period, revenue from sales of other parts and components amounted to RMB112 million, representing an increase of RMB34 million as compared to the corresponding period last year.

Production, Research and Development and Services

The Group is proactively expanding its production capacity. During the Period, the Group's capital expenditure on infrastructure developments, such as factory expansion and equipment purchasing, amounted to RMB81 million, representing an increase of RMB54 million as compared to the corresponding period last year.

During the Period, the Group successfully developed and exported a 9,000 metre digitally-controlled land rig. This demonstrated that the Group has reached a new technology level within the drilling rig industry and enhanced its core competitiveness. At the same time, the Group is accelerating the research and development process on land-made offshore equipment mobile system, 12,000 metre drilling rigs, slidetrack rigs, continuous pipe rigs and so on. For the supply of rig parts and components, the Group is focused on research for high valued added rig parts and components. This further enriched our product portfolio and improved product line, enhancing our leading position in technology in the industry. Meanwhile, the Group obtained 8 technology patents for oil equipment production. As at 30 June 2008, the Group has a total of 15 technology patents for oil equipment production.

The Group's products are well received by both domestic and international clients, not only due to the high quality and competitive price of the products, but also due to the engineering services provided by the Group. The Group uses educational drilling rigs for employee training and demonstration to clients. The Group has optimized the process of pre-sale installation and testing, and will also send an experienced engineering team to drilling sites for post-sale technical support and services. This raises clients' satisfaction towards the Group, building an important foundation to further expand into the international market.

MARKET EXPANSION

In terms of international market expansion, Russia has become one of the Group's main focus markets since 2006. During the Period, the Group's products achieved good sales results in the Russian market. The sale of drilling rigs increased from 3 to 12 units during the Period, as compared to the corresponding period last year. The total sale to Russia contributed 56.0% to the Group's export revenue. Honghua International Co., Ltd., a subsidiary of the Group, has set up a representative office in Uzbekistan on 12 August 2008. This representative office is responsible for product promotion, contact and consultation, technology support, market research and so on. The Group is also actively expanding into the South American, African, Middle Eastern and South East Asian markets. This can better position the Group to capture the upgrade and replacement demand of global land drilling rigs.

PROSPECTS

The strong demand for oil has led to the increase of global exploitation activities, as a result, the demand for drilling rigs is increasing. From 2002 to 2007, the land rigs which are in operation increased from 3,013 units to 4,951 units globally, representing a CAGR of 10.4%. It is expected that from 2008 to 2012, the number of operational land rigs will increase from 5,104 units to 5,869 units globally, representing a CAGR of 3.55%, and annual demand for new built land rigs is estimated to increase from 388 units to 439 units.

As drilling activities increase, many drilling rigs which are currently in operation will enter into the maintenance and renewal stage. Land rigs are aiming to achieve the objectives of "deeper, more difficult and denser". In the coming years, China and Russia will be in the leading position of global land rig demand. We foresee the demand of new land rigs by China and Russia will reach approximately 80% of global demand by the end of 2010.

In order to satisfy the enormous market demand, the Group plans to spend 12% of the funds raised from the Initial Public Offering to expand production capacity and research and development of new land rigs equipment and components. The Group foresees that upon the completion of the capacity expansion program, annual production can reach 150 units of land rigs, 500 units of mud pumps and 20 units of top drives at the end of 2008.

At the same time, in order to further increase the market share in Russia, the Group is planning to set up a subsidiary in Moscow to provide sales and post-sale services at the end of 2008. This will further consolidate the Group's components supply distribution network.

Looking forward, realizing the dream of Honghua Group — offshore drilling platform, this will unveil a new era for the Group in 2008. The site selection for the production base for offshore drilling equipment production will be finished in the second half of 2008, and the Group will commence building infrastructure facilities. Having the ability to produce in-house offshore drilling modules, state-of-art land-made offshore equipment, a global marketing network and full support from strategic investors create a unique competitive edge. This allows the Group's venture into the offshore drilling rig market to proceed at a stable and healthy pace.

Looking ahead, the Group will strive to capture the enormous business opportunities brought upon by the growing global demand of drilling rig equipment in emerging markets. The Group will continue to expand its worldwide distribution network, enhance products lines, as well as put further research and development efforts into new and high value added parts and components. This will continuously enhance the Group's production efficiency, leading to better cost control capacity and enhanced profitability. At the same time, building upon the solid foundation with existing partners, the Group will continue to prudently seek strategic alliance, joint-venture or merger and acquisition opportunities, further improving the Group's oil exploration and exploitation equipment portfolio, therefore consolidating Honghua's leading position in the drilling rig market.

Honghua Group's successful development and achievements have been helped in large by support from the Chinese government and the society in general. In order to give back to the society, management and employees of the Group have been actively donating to the areas affected by the 512 earthquakes, and also supporting reconstruction work. In addition, the Group and dozens of shareholders of the Group have committed to donate more than RMB10 million for the purpose of building a Guanghan Honghua Foreign Language School. This can contribute to the reconstruction of schools in affected areas. The Group will fulfill its commitment to be an enterprise with sound corporate and social responsibilities. We will strive to make a significant contribution to oil exploitation industry in the future.

FINANCIAL REVIEW

Revenue

During the Period, our revenue amounted to RMB1,503 million, representing an increase of 23.0% as compared to RMB1,222 million in the corresponding period last year. The increase was mainly attributable to the increased sales of drilling rigs, particularly driven by the Russian, South Asian and South East Asian markets.

During the Period, sales by geographical areas were as follows. Revenue from export of the Group amounted to approximately RMB1,323 million, representing an increase of 102.4% as compared to the corresponding period last year, and accounted for 88.0% of the total revenue of the Group. Sales from the European market grew rapidly. This was mainly due to the demand for new drilling rigs in Europe and our Group's achievement in the market expansion to Russia. During the Period, the Middle Eastern market showed a steady growth, while other markets, such as the South Asian and South East Asian markets, have shown promising growth potentials, as compared to the same period last year.

Sales by Geographical Areas	**For the 6 months ended 30 June 2008** *RMB'000*	**% of Total Revenue**	For the 6 months ended 30 June 2007 *RMB'000*	% of Total Revenue	Change *(%)*
China	**180,006**	**12.0%**	568,600	46.5%	–68.3%
North America	**147,833**	**9.8%**	397,745	32.5%	–62.8%
Middle East	**6,635**	**0.4%**	2,929	0.2%	126.5%
Europe	**745,691**	**49.6%**	114,245	9.3%	552.7%
Others	**422,696**	**28.2%**	138,537	11.5%	205.1%
Total Revenue	**1,502,861**		1,222,056		23.0%
Total Exports	**1,322,855**	**88.0%**	653,456	53.5%	102.4%

During the Period, sales by product categories of drilling rigs and rig parts and components amounted to approximately RMB1,362 million and RMB141 million as compared to RMB1,073 million and RMB149 million respectively in the corresponding period last year, representing an increase of 26.9% and a decrease of 5.4%. Drilling rigs include digitally-controlled rigs and conventional rigs, where sales of digitally-controlled rigs and conventional rigs were approximately RMB1,150 million and RMB212 million respectively. The increase of drilling rigs was mainly attributable to the sales growth of digitally-controlled rigs. The decrease of parts and components was mainly due to the decline in sales of mud pumps to RMB29 million during the Period as compared to RMB70 million in the corresponding period last year.

Cost of Sales

During the Period, the Group's cost of sales amounted to approximately RMB1,057 million, representing an increase of approximately RMB233 million or 28.3% as compared to the corresponding period last year. The increase was mainly attributable to the corresponding increase of the Group's revenue and the increase in the costs of raw materials.

Gross Profit and Gross Margin

During the Period, the Group's gross profit recorded approximately RMB446 million, representing an increase of 11.9% as compared to the corresponding period last year. Gross profit from drilling rigs amounted to approximately RMB403 million, representing an increase of 15.3% as compared to the same period last year. Among which, gross profits from digitally-controlled rigs and conventional rigs were RMB342 million and RMB61 million respectively, representing an increase of 7.5% and 95.2% as compared to the corresponding period last year. Gross profit from rig parts and components amounted to approximately RMB43 million, representing a decrease of 14.6% as compared to the same period last year.

During the Period, the Group's overall gross margin was 29.7%, representing a decrease of 2.9 percentage points as compared to 32.6% in the corresponding period last year. The gross margin of drilling rigs was approximately 29.6%, representing a decrease of 2.8 percentage points as compared to the corresponding period last year. During the Period, cost of raw materials continuously increased, while the RMB also appreciated at a fast pace. As a result, the Group's sales, which are dominated in US dollars suffered adversely. The Group maintained a stable overall gross margin, which was attributable to the effective measures on the adjustments on the selling prices and the partial production cost and the impacts from the fluctuation of exchange rate transferred to customers. Gross margins of digitally-controlled rigs and conventional rigs were 29.7% and 28.8% respectively, representing a decrease of 3.8 percentage points and an increase of 3.8% percentage points as compared to the corresponding period last year. Gross margin of rig parts and components was 30.3%, representing a decrease of 3.3 percentage points as compared to the same period last year. The margin decrease in rig parts and components was mainly due to the competitiveness in the rig parts and components market and the selling price adjustments in mud pumps.

Other Net Operating Revenue and Other Net Income

During the Period, the Group's other net operating revenue amounted to approximately RMB1.01 million, representing a decrease of approximately RMB1.70 million or 62.9% as compared to the corresponding period last year. Other net income amounted to approximately RMB4.72 million, representing an increase of RMB1.35 million or 40.0% as compared to the corresponding period last year. The increase was mainly attributable to the net change of the increase in government subsidy to the research and development and the donation to Sichuan earthquake.

Expenses in the Period

During the Period, the Group's selling expenses amounted to approximately RMB124 million, representing an increase of RMB52 million or 72.9% as compared to the corresponding period of the previous year. Transportation costs significantly grew by RMB45 million as compared to the corresponding period in 2007. The increase in transportation costs was mainly attributable to the increased sales to Russia. During the Period, sales to the Russian market accounted for 49.3% (approximately RMB741 million) of the Group's total revenue as compared to 9.3% (approximately RMB114 million) in the corresponding period last year. The Group was responsible for the related transportation cost, which was proportional to the increase of sales.

During the Period, the Group's general and administration expenses amounted to approximately RMB113 million, representing an increase of RMB53 million or 89.3% as compared to the corresponding period last year. The increase was mainly attributable to the related expenses for providing share options to employees and the increase in labour costs and research and development expenses.

During the Period, the Group's net financing cost amounted to approximately RMB74 million, representing an increase of RMB64 million or 602.2% as compared to the corresponding period last year. The increase was mainly attributable to the growth of net interest expenses, driven by the increased borrowings and interests rate, and the greater exchange loss. The greater exchange loss was mainly due to the decreased amount of RMB equivalents to the receivables denominated in foreign currencies, caused by the RMB appreciation.

Share of Profits from a Jointly-controlled Entity

During the Period, the Group's share of profits from a jointly-controlled entity amounted to approximately RMB11 million, which was mainly attributable to the sales of drilling rigs.

Profit before Taxation

During the Period, profit before taxation of the Group amounted to approximately RMB151 million, representing a decrease of RMB111 million or approximately 42.5% as compared to the corresponding period last year.

Income Tax Expenses

During the Period, the Group's income tax expenses amounted to approximately RMB25 million, representing a decrease of RMB17 million or approximately 39.9% as compared to the corresponding period last year. The decrease was mainly attributable to the fall in profit before taxation. During the Period, the effective tax rate was 16.5%, which was on a par with approximately 15.8% in the corresponding period last year. Honghua Company a subsidiary of the Group, was exempt from the PRC enterprise income tax last year. According to the agreement of related authority, Honghua Company was taxed at 50% of the prevailing tax rate.

Profit for the Period

During the Period, the Group's profit amounted to approximately RMB126 million, representing a decrease of RMB95 million or 43.0% as compared to the corresponding period last year. Among which, earnings attributable to equity shareholders of the company were approximately RMB126 million, while net loss of minority interest was approximately RMB37,000.

Net profit margin is 8.4%, representing a decrease of 6.8 percentage points as compared to the corresponding period last year. The decrease was mainly attributable to the rising expenses during the Period.

Dividend

Pursuant to the prospectus dated 25 February 2008, the Group proposed that the annual dividends for 2008 be not less than 20% of the earnings attributable to equity shareholders of the company. No interim dividend was declared for the six months ended 30 June 2008. The Board declared a special dividend after the interim period of Hong Kong Dollars 10 cents per share.

Sources of Capital and Borrowings

The Group's principal sources of capital include listing proceeds, cash from operations, bank borrowings and capital injection from investors. Raw materials purchasing and other operational expenses, acquisition of land use rights and other fixed assets as well as settlement of interest and loan constitute the demand of the Group for cash. Part of the listing proceeds are placed as 3 month fixed deposits.

As at 30 June 2008, the Group's borrowings amounted to approximately RMB820 million, representing a decrease of approximately RMB52 million as compared to the beginning of 2008. Among which, borrowings repayable within one year amounted to approximately RMB805 million, representing a decrease of RMB51 million as compared to the beginning of 2008.

Deposit and Cash Flow

At the end of the Period, the Group's cash and cash equivalents amounted to approximately RMB1,072 million, representing an increase of approximately RMB877 million as compared to the beginning of 2008. During the Period, the Group's operating cash outflow amounted to approximately RMB1,158 million, including RMB1,536 million which was placed as time deposits with original maturity more than three months; the investment cash outflow amounted to approximately RMB93 million; cash inflow from financing activities amounted to approximately RMB2,129 million.

Asset Structure and Changes Thereof

At the end of the Period, the Group's total assets amounted to approximately RMB6,644 million, representing an increase of RMB2,713 million or approximately 69.0% as compared to the beginning of 2008. Among which, current assets amounted to approximately RMB5,744 million, which were mainly inventories, trade and other receivables, listing proceeds and bank deposits and accounted for approximately 86.5% of total assets; non-current assets amounted to approximately RMB900 million, accounting for approximately 13.5% of total assets.

Liabilities

At the end of the Period, the Group's total liabilities amounted to approximately RMB2,129 million, representing an increase of approximately RMB446 million as compared to the beginning of 2008. Among which, current liabilities amounted to approximately RMB2,109 million, accounting for approximately 99.1% of total liabilities; non-current liabilities amounted to approximately RMB20 million, accounting for approximately 0.9% of total liabilities. At the end of the Period, the Group's gearing ratio is approximately 12.3%.

Total Equity

At the end of the Period, total equity amounted to RMB4,515 million, representing an increase of RMB3,160 million as compared to the beginning of 2008. Total equity attributable to equity shareholders of the company amounted to approximately RMB4,452 million, representing an increase of RMB3,164 million as compared to the beginning of 2008; minority interests totaled approximately RMB64 million, representing a decrease of RMB5 million as compared to the beginning of 2008. Net asset value reached approximately RMB1.34 per share. During the Period, the Group's earnings per share were approximately RMB4.16 cents.

Turnover

During the Period, the average days of inventories increased to 188 days from 216 days in the corresponding period in 2007. This was mainly attributable to the earlier purchase of raw materials to manage the production costs, the increase in product lines, the delay in product delivery caused by the earthquakes, and the inventories planned to be delivered in the second half of 2008.

The Group proactively managed the cash flow, as a result, it maintained stable financial ratios. The Group prudently monitored recoverability of its account receivables, observed the financial condition of its customers and intensified cash collections. The average days of trade receivables maintained relatively stable and increased to 119 days during the Period from 108 days in the corresponding period last year. During the Period, the average days of trade payables increased to 130 days from 137 days in the corresponding period last year.

Contingent Liabilities and Pledge

At the end of the Period, details of contingent liabilities are set out in note 21 to the interim financial report. The Group have pledged bank deposits of RMB241 million, representing a decrease of RMB20 million as compared to the beginning of 2008.

Capital Expenditure, Major Investment and Capital Commitments

During the Period, capital expenditure of the Group on infrastructure and technical improvements amounted to RMB81 million, representing an increase of RMB54 million as compared to the corresponding period last year. This was mainly due to the investment in expanding production base, purchase of equipments and other infrastructure developments, to better capture the surging demand in the oil drilling industry in coming years.

At the end of the Period, the Group had capital commitments of RMB965 million, which will be used for expanding the Group's production capacity.

Foreign Currency Risk

The Group owns certain foreign currency deposits. At the end of the Period, the Group's foreign currency deposits were equivalent to RMB748 million, trade receivables and other receivables in foreign currency were equivalent to RMB711 million. Exports and foreign currencies settled business exposed the Group to exchange risk.

Use of Proceeds from the Initial Public Offering

The net proceeds after the reduction of the related expenses from the initial public offering was HK$2,958 million. The Group used the net proceeds as stated in the "Use of Proceeds" section in Prospectus dated 25 February 2008. As at 30 June, 2008, the use of net proceeds is as follows: proceeds of HK$1,775 million to be used for the offshore project, none has incurred; proceeds of HK$592 million to be used for potential acquisitions, none has incurred; proceeds of HK$354 million to be used for production capacity expansion and R&D expenses, among which HK$81 million has incurred; proceeds of HK$237 million to be used and has incurred as working capital and day to day expenses.

Employee Remuneration and Benefit

During the Period, the average number of the Group's employees were 3,505. The total remuneration and benefit amounted to RMB101 million, representing an increase of RMB35 million or approximately 52.1% as compared to the corresponding period last year. The Group provided competitive remuneration and benefit to its employees, and determined employee's individual remuneration based on his job duties, work performance and individual capability. The Group strives to maintain its outstanding corporate culture, implement a people-oriented principle and build up a broad stage for the employee to fulfill one's value under the Group's systematic training and its employee skill enhancement plans.

PURCHASE, SALE AND REPURCHASE OF THE LISTED SECURITIES OF THE COMPANY

The company did not purchase, sell and repurchase any of its shares during the six months ended 30 June 2008.

CLOSURE OF REGISTER OF MEMBERS

The register of members of the company will be closed from Thursday, 2 October 2008 to Monday, 6 October 2008, both days inclusive, during which period no transfer of shares can be registered. In order to qualify for the above special dividend, all transfers accompanied by the relevant share certificates must be lodged with the company's Hong Kong share registrar and transfer office, Computershare Hong Kong Investor Services Limited, at Shops 1712–1716, 17th Floor, Hopewell Centre, 183 Queen's Road East, Wanchai, Hong Kong for registration not later than 4:30 p.m. on Tuesday, 30 September 2008. The special dividend will be paid around Friday, 17 October 2008.

AUDIT COMMITTEE

The audit committee of the company (the "Audit Committee") comprises all independent non-executive Directors with written terms of reference in compliance with the Listing Rules. The Audit Committee is responsible for reviewing and supervising financial reporting process and internal control system and offers advice and recommendations to the Board. The Audit Committee shall meet at least twice a year and review the internal auditors' opinion, internal control, risk management and financial reporting. The interim results have been reviewed by the Audit Committee and KPMG, the company's auditors.

COMPLIANCE WITH THE CODE ON CORPORATE GOVERNANCE PRACTICES

Since the Listing Date, the company has at all times complied with the Code on Corporate Governance Practices ("CG Code") contained in Appendix 14 of the Rules Governing the Listing of Securities Listing Rules except for the following deviations:

As set out in Provision A.2.1 of the CG Code, the roles of Chairman and President (Chief Executive Officer) should be separated and should not be performed by the same individual. Mr. Zhang Mi was appointed the Chairman of the Board and President (Chief Executive Officer) of the company. As Mr. Zhang Mi is one of the founders of the Group and possesses rich knowledge and experience of the industry and the related industries, therefore, the Board believes that vesting the roles of both Chairman and President (Chief Executive Officer) in Mr. Zhang Mi provides the company with strong and consistent leadership, allows for effective and efficient planning and implementation of business decisions and strategies, and ensures the shareholders' benefits as a whole. In addition, the balance between the power and responsibilities is achieved through the cooperation of the Board and the Committees.

The company will continue to review the effectiveness of the Group's corporate governance structure and consider whether any changes, including the separation of roles of Chairman and President (Chief Executive Officer) are necessary.

MODEL CODE FOR SECURITIES TRANSACTIONS BY DIRECTORS OF THE GROUP

The company has adopted the Model Code for Securities Transactions by Directors of Listed Issuers ("Model Code") set out in Appendix 10 of the Listing Rules. After specific enquiry made by the company, all of the Directors confirmed that they have complied with the required standard set out in the Model Code and the code of conduct regarding the Directors' securities transactions during the reporting period.

PUBLICATION OF INTERIM RESULTS ANNOUNCEMENT AND INTERIM REPORT IN 2008

This announcement will be published on both the websites of the company (www.hh-gltd.com) and of Stock Exchange (www.hkexnew.hk). The interim report of the company for the year ended 30 June 2008 will be dispatched to shareholders and published on the aforesaid websites in due course.

APPRECIATION

On behalf of the Board, I would like to take this opportunity to express heartfelt thanks to management and all employees for creating fruitful wealth to the company in the past with their creative hard work and impressive results admirable by the peers in the world and thanks to the shareholders, business partners and investors for their continuous support.

On behalf of the Board of
Honghua Group Limited
Zhang Mi
Chairman

PRC, 16 September 2008

As at the date of this announcement, our directors are Mr. Zhang Mi (Chairman), Mr. Ren Jie and Mr. Liu Zhi as executive Directors, Mr. He Sean Xing, Mr. Xiang Qingsheng and Mr Siegfried Meissner, as non-executive Directors, and Mr. Chen Guoming, Mr. Tai Kwok Leung, Alexander, Mr. Liu Xiaofeng, Mr. Liu Yinchun, Mr. Qi Daqing, Mr. Wang Chunlin and Mr. Wang Li as independent non-executive Directors.