

Matsuoka Mechatronics (China) Co., Limited

2005 Auditor's Report

Hangzhou Xiaoran Certified Public Accountants

AUDITOR'S REPORT

Hangxiao Hui Audit Zi (2006) No.390

To the Board of Directors

Matsuoka Mechatronics (China) Co., Limited

We have audited the accompanying financial statements of Matsuoka Mechatronics (China) Co., Limited (hereinafter '**Company**'), which comprises the balance sheet as at 31 December 2005, the income statement and statement of profit distribution and cash flow statement for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an audit opinion on these financial statements based on our audit.

We conducted our audit in accordance with the Independent Auditing Standards for Certified Public Accountants. Those Standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidencing supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

The Company does not include the accrual of the fixed assets depreciation which is 380,707.10 RMB Yuan.

In our opinion, except the abovementioned, the financial statements are presented fairly, in all material aspects, of the financial position as of December 31 2005, and the results of its operations and its cash flows for the years then ended in accordance with the requirements of both the Accounting Standard for Business Enterprises and other relevant financial and accounting laws and regulating promulgated by the State.

Hangzhou Xiaoran Certified Public Accounts Co., Ltd (Seal)

Hangzhou China

Chinese Certified Accountant: Wang Lingqiu (Signed & Sealed)

Chinese Certified Accountant: Shen Liang (Signed & Sealed)

Report Date: 21 February 2006

Consolidated Balance Sheet

Company Name: Matsuoka Mechatronics (China) Co., Limited 31/12/2005

Amount Unit: RMB Yuan

Assets	Row No.	Beginning Balance	Ending Balance	Liabilities and shareholder equity	Row No.	Beginning Balance	Ending Balance
Current Assets:	1	29,084,389.69	36,243,274.54	Current Liabilities:	51		
Monetary funds	2			Short term borrowing	52		
Short-term investment	3			Notes payable	53		
Notes receivable	4			Accounts payable	54		
Dividend receivable	5			Advance from customers	55		
Interest receivable	6			Current payroll	56		
Account receivable	7			Welfare expense payable	57		
Other receivable	8	2,692,993.53	26,915,145.85	Dividend payable	58		
Advanced to suppliers	9			Taxes payable	59		
Subsidies receivable	10			Other amount	60		
Inventory	11			Other amount payable	61	20,000,200.00	15,028,332.20
Prepaid expense	12			Accrued expenses	62		
Long-term debt investment within 1 year	13			Estimated liabilities	63		
Other current assets	14			Long term liabilities within a year	64		
	15			Other current liabilities	65		
	16				66		
Total Current Assets	17	31,777,383.22	63,158,420.39	Total Current Liabilities	67	20,000,200.00	15,028,332.20
	18				68		
Long term investment	19			Long term liabilities:	69		
Long term equity investment	20			Long term borrowing	70		
Long term debt investment	21			Bonds payable	71		
Total Long Term Investment	22			Long term payables	72		
	23			Special payables	73		
Fixed Assets	24			Other long term payables	74		
Fixed assets – original cost	25	5,517,867.25	8,178,096.93		75		
Less: Accumulated depreciation	26			Total Long Term Liabilities	76		
Fixed asset net value	27	5,517,867.25	8,178,096.93		77		
Less: Fixed assets impairment	28			Deferred tax liabilities	78		
Fixed assets net book value	29	5,517,867.25	8,178,096.93	Deferred tax loan liabilities	79		
Construction materials	30				80		
Construction in progress	31	8,286,004.50	9,668,835.30	Total Liabilities	81	20,000,200.00	15,028,332.20
Fixed assets pending disposal	32				82		
	33				83		
Total Fixed Assets	34	13,803,871.75	17,846,932.23		84		
Intangible and other assets	35			Owner's Equity	85		
Intangible assets	36			Capital stock	86	25,658,425.54	66,188,310.14
Long term prepayments	37	77,370.57	211,289.72	Capital reserve	87		
Other long term assets	38			Surplus reserve	88		
	39			Including statutory welfare reserve	89		
Total Intangible & Other Assets	40	77,370.57	211,289.72	Undistributed profit	90		
Deferred Tax Items	41				91		
Deferred tax borrowing items	42			Total Owners' Equity	92	25,658,425.54	66,188,310.14
	49				99		
Total Assets	50	45,658,625.54	81,216,642.34	Total Liabilities and Owners' Equity	100	45,658,625.54	81,216,642.34

Consolidated Profit Statement and Statement of Profit Distribution

Company Name: Matsuoka Mechatronics (China) Co., Limited Year of 2005 Amount Unit: RMB Yuan

Item	Row No	Last Year Balance	This Year Balance
1. Revenue from main operations	1		
Less: Cost of main operations	2		
Taxes and surcharge for main operations	3		
	4		
2. Profit from main operations	7		
Add: Profit from other operations	8		
Less: Operating expenses	9		
Administrative expenses	10		
Financial expenses	11		
	12		
3. Operating profit	14		
Add: Investment income/loss	15		
Revenue from subsidies	16		
Non-operating revenue	17		
Less: Non-operating expenditure	18		
	19		
4. Total Profit	21		
Less: Income tax	22		
	23		
5. Net Profit	24		
Add: Undistributed profit at the beginning of the year	25		
Adjustment from last year balance	26		
Other adjustments	27		
6. Profit To Be Distributed	28		
Less: Appropriation of surplus reserve	29		
Appropriation of public welfare fund	30		
Appropriation of reserve fund	31		
Appropriation of enterprise expansion fund	32		
Appropriation of employee welfare and bonus fund	33		
7. Profit To Be Distributed To Investors	34		
Less: Dividend payable on preferential stock	35		
Appropriation of discretionary surplus reserve	36		
Dividend payable on common stock	37		
Common stock dividend converted into capital	38		
	39		
8. Undistributed Profit	40		

Supplementary Information

Item	This Year Balance	Last Year Balance
1. Gain on sale and disposal of department or an invested enterprise		
2. Losses arising from natural disasters		
3. Increase/decrease in income before tax due to a change in accounting policy		
4. Increase/decrease in income before tax due to a change in accounting estimate		
5. Loss arising from debt restructuring		
6. Others		

Consolidated Cash Flow Statement

Company Name: Matsuoka Mechatronics (China) Co., Limited Year of 2005 Amount Unit: RMB Yuan

Items in Financial Statement	Row No	Amount	Supplementary Information	Row No	Amount
1. Cash Flow from Operating Activities	1		1. Reconciliation of profit to cash flows from operating activities	51	
Cash received from sale of goods or tendering of services	2		Net profit	52	
Refunds of taxes	3		Add: Provision for impairment of assets	53	
Other cash receipts relating to operating activities	4	5,021,867.80	Depreciation of fixed assets	54	
	5		Amortisation of intangible assets	55	
Sub-total of Cash Inflows	6	5,021,867.80	Amortisation of long term prepayments	56	
Cash paid for goods and services	7		Decrease in prepaid expenses (decrease: increase)	57	
Cash paid for and on behalf of employees	8		Increase in accrued expenses (decrease: decrease)	58	
Payments of all type of taxes	9		Losses on disposal of fixed assets, intangible assets and other long term assets (decrease: gain)	59	
Other cash payments relating to operating activities	10	34,349,807.07	Losses on scrapping of fixed assets	60	
	11		Financial expenses	61	
Sub-total of Cash Outflows	14	34,349,807.07	Investments losses (decrease: gain)	64	
Net cash flows from operating activities	15	-29,327,939.27	Deferred tax credit (decrease: debit)	65	
2. Cash Flows From Investing Activities	16		Decrease in inventories (decrease: increase)	66	
Cash received from return of investments	17		Decrease in operating receivables (decrease: increase)	67	-24,356,071.47
Cash received from return on investments	18		Increase in operating receivables (decrease: decrease)	68	
Net cash received from the sale of fixed assets, intangible assets and other long term assets	19		Other	69	
Other cash receipts relating to investing activities	20			70	
	21			71	-29,327,939.27
Sub-total Of Cash Inflows	22		Net Cash Flow from Operating Activities	72	
Cash paid to acquire fixed assets, intangible assets, and other long term assets	23	4,043,060.48		73	
Cash paid to acquire investments	24		2. Investing and financing activities that do not involve cash receipts and payments	74	
Other cash payments relating to investing activities	25		Conversion of debt into capital	75	
	26		Convertible bonds to expire within one year	76	
Sub-total Of Cash Outflows	27	4,043,060.48	Fixed assets under finance lease	77	
Net cash flows from investing activities	28	-4,043,060.48		78	
3. Cash Flows From Financing Activities	29			79	
Cash received from investment by others	30	40,529,884.60	3. Net Increase in cash and cash equivalents	80	
Cash received from borrowings	31		Cash at the end of the period	81	36,243,274.54
Other cash receipt relating to financing activities	32		Less: Cash at the beginning of the period	82	29,084,389.69
	33		Add: Cash equivalents at the end of the period	83	
Sub-total of Cash Inflows	34	40,529,884.60	Less: Cash equivalents at the beginning of the period	84	
Cash repayment of amounts borrowed	35			85	
Cash paid for distribution of dividends or profits and for interest expenses	36			86	
Other cash payments relating to financing activities	37			87	
	38			88	
Sub-total of Cash Outflows	42			92	
Net cash flows from financing activities	43	40,529,884.60		93	
4. Effect Of Changes In Foreign Exchange Rate on Cash	44			94	
5. Net Increase in Cash AND Cash Equivalents	45	7,158,884.85	Net increase in cash and cash equivalents	95	7,158,884.85

Company responsible person: Wei Guohua

Company accounting responsible person: Zheng Zhongliang

Accounting firm responsible person: Tang Hongxia

Matsuoka Mechatronics (China) Co., Limited
Notes for 2005 Consolidated Financial Statements

I. General

Established and invested by Matsuoka International Group Co., Limited, the Company is a foreign invested company. It was approved by Zhejiang Provincial Ministry of Commerce on 10 February with approval certificate number [2003]032023 and registered with Commerce and Industrial Administration Bureau on 18 March 2003 upon which the Company obtained the enterprise legal person business licence with serial number 004873. The Company has a registered capital of 8 million US Dollars, with the approved operating period of 50 years. The Company is still experiencing the preparation period.

The Company's business scope includes: Research and manufacturing intelligent artificial crystal growth equipments and spare parts, artificial optical crystal, intelligent health and entertainment equipments and spare parts.

II. Basis for compilation of this financial statements

The company is applying Accounting Standard for Business Enterprises and Accounting System for Business Enterprises and its supplementary stipulations.

III. Company's major accounting policies and accounting estimation

1. Accounting system

The Company is applying Accounting Standard for Business Enterprises and Accounting System for Business and Accounting System for Business Enterprises and its supplementary stipulations.

2. Accounting year

This accounting year covers the calendar year from 1 January to 31 December.

3. Reporting currency

The reporting currency is the Renminbi

4. Accounting method and pricing principle:

The Company adopts accrual basis accounting method and historical costs as pricing principle.

5. Foreign currency transactions

Transactions denominated in foreign currencies are translated into Renminbi (RMB) at the basic exchange rate announced by the People's Bank of China at the beginning of the month in which the transaction occurs. At the end of an accounting period, the balances of foreign currency accounts for assets and liabilities are restated at the basic exchange at the end of accounting period. The exchange gain or losses generated from the restatement are treated differently under different circumstances: Exchange gains or losses incurred during pre-operating of a company are recorded in the long term prepayments. When the Company starts to operate, the exchange gains or losses are transferred into the profit and loss of the month it starts to operate at one time; Exchange rate gains or losses incurred during operation of a company, the exchange gains or losses are recorded as financial expense; Exchange gains or losses arising from a specific borrowing for the acquisition of a fixed assets are capitalised as part of the cost of fixed asset.

6. Cash and cash equivalent

Cash equivalents are short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an significant risk of changes in value.

7. Provision for bad debts

Criteria for recognition of bad debts: The debtor has been dead, after settlement from him inheritance the

debt still can not be recovered; the debtor has gone bankruptcy; the debtor has not repaid the debt over a long time, and there are reasonable grounds to believe that the receivables are unlikely to be recovered.

Calculation of bad debts: the Company adopts allowance method for calculating bad debts.

Provision for extraction of bad debts: The provision for bad debts is undertaken through analysing the balance of the receivables (including receivable liabilities and other receivable) at the end of period.

8. Fixed assets and depreciation

Fixed assets are high unit price tangible assets that have useful life more than one year, and are held for use in the production or supply of goods or services, for rental to others or for administrative purposes. Fixed assets record at the actual cost as original cost on acquisition.

Depreciation is calculated with average service life method. Depreciation rate is determined by assets type, expected service life and expected residual value (10% of the original value):

Asset Type	Service Life (years)	Annual Depreciation Rate (%)
Building & construction	20	4.5
Machinery and other equipment	10	9
Operating Machinery	10	9
Transport vehicle	5	18
Electronic and other equipments	5	18

9. Construction in progress

Construction in progress is stated according to actual expenditure. Construction in progress is transferred to fixed assets when it has reached the expected usable condition.

During the construction in progress inspection at the end of the period, if there is any evidence indicating a decline in value of the construction in progress, a provision for impairment is made.

10. Long-term unamortized expenses

Long-term unamortized expenses include fees for increasing electricity capacity and other expenses which will to be amortized for the period of more than 1 year (excluding 1 year) during the beneficiary period, by extracting actual expenses from the accumulated amortized amount.

All the costs incurred during the pre-operation period shall be accumulated as long term unamortized expenses. When the Company commences operation, it will be incorporated into the profit and loss of the first month of the Company's operation.

11. Assets impairment

In addition to the accrual of receivables and inventories reduced value explained in the above accounting polices, other assets when their book value may have exceeded their actual recoverable value due to certain signs or change of circumstances, the value of these assets shall be reduced. The difference will be deemed as assets impairment value.

Recoverable value for a single asset is the higher of its net sale price and its useable value. Net sale price means the net value realised by this asset (excluding disposal costs) when parties enter into a fair transaction under a familiar trading environment. Useable value means the current value of the expected future cash flow this asset could realise by continuing utilizing this asset during its service period.

When the cause resulting in the impairment has partially or completely disappeared, the provision for assets impairment should be reversed based on the loss determined in the previous year.

IV. Taxation

The Company is still at pre-operation period.

V. Distribution of profit

The Company is still at pre-operation period.

VI. Notes on consolidated financial statements

Notes relating to consolidated balance sheet

Amount Unit: RMB Yuan

1. Currency funds

Ending balance: 36,243,274.54

Bank deposit	RMB	36,242,134.51
Bank deposit	USD	1,140.03
Total		36,243,274.54

2. Other receivables

Ending balance: 26,915,145.85

(1) Receivable aging analysis	Amount	Percentage
Less than 1 year	26,270,639.00	97.61%
1 to 2 years	644,506.85	2.39%
Total	26,915,145.85	100%
(2) Other receivables in relatively large sum		
Company or project	Amount	Content and nature
Zhejiang Xiaoshan Jiangong Group Co., Ltd	24,500,000.00	Incomings and outgoings
(3) No outstanding receivables from related parties		
No need for this year to make provisions for bad debt		

3. Fixed assets and accumulated depreciation

Ending balance: 8,8178,096.93

(1) Original price of the fixed assets

Type	Initial balance	Increasing this year	Decreasing this year	Ending balance
Building & construction	5,106,150.00	0.00	0.00	5,106,150.00
Machinery and other equipment	0.00	2,048,486.68	0.00	2,048,486.68
Operating Machinery	0.00	611,743.00	0.00	611,743.00
Transport vehicle	407,718.25	0.00	0.00	407,718.25
Electronic and other equipments	3,999.00	0.00	0.00	3,999.00
Total	5,517,867.25	2,660,229.68	0.00	8,178,096.93

(2) Accumulated depreciation

Type	Initial balance	Increasing this year	Decreasing this year	Ending balance
Building & construction	0.00	0.00	0.00	0.00
Machinery and other equipment	0.00	0.00	0.00	0.00
Operating Machinery	0.00	0.00	0.00	0.00
Transport vehicle	0.00	0.00	0.00	0.00
Electronic and other equipments	0.00	0.00	0.00	0.00
Total	0.00	0.00	0.00	8,178,096.93

(3) Net value of fixed assets

Type	Opening balance	Ending balance
Building & construction	5,106,150.00	5,106,150.00
Machinery and other equipment	0.00	2,048,486.68
Operating Machinery	0.00	611,743.00
Transport vehicle	407,718.25	407,718.25
Electronic and other equipments	3,999.00	3,999.00
Total	5,517,867.25	8,178,096.93

No need for this year to provide provision for assets impairment

4. Projects in progress

Closing balance: 9,668,835.30

Name of the project	Initial balance	Increasing this year	Decreasing this year	Closing balance
New Project	8,286,004.50	1,382,830.80	0.00	9,668,835.30
Total	8,286,004.50	1,382,830.80	0.00	9,668,835.30

No need for this year to provide provision for impairment of the project being constructed

5. Long-term unamortized expenses

Closing balance: 211,289.72

Project	Initial balance	Increasing this year	Amortized amount in this period	Closing balance
Pre-operation established fee	77,370.57	133,919.15	0.00	212,289.72
Total	77,370.57	133,919.15	0.00	212,289.72

6. Other payables

Closing balance: 15,028,332.20

(1) Relatively large sum of payables – 10% or over 10% of this item		
Company or project	Amount	Nature and content of the fund
Zhejiang Matsuoka Industrial Co., Ltd.	14,929,887.40	Incomings and outgoings
(2) Related parties transactions		
Name of the related parties	Amount	Nature
Zhejiang Matsuoka Industrial Co., Ltd.	14,929,887.40	Incomings and outgoings
Total	14,929,887.40	

7. Capital Stock

Closing balance: 66,188,310.14

(1) RMB Amount				
Investor	Initial balance	Increasing this year	Decreasing this year	Closing balance
Matsuoka International Group Co., Ltd	25,658,425.54	40,529,884.60	0.00	66,188,310.14
Total	25,658,425.54	40,529,884.60	0.00	66,188,310.14
(2) Foreign Currency				
Investor	Initial balance	Increasing this year	Decreasing this year	Closing balance
Matsuoka International Group Co., Ltd	3,100,020.00	4,899,980.00	0.00	8,000,000.00
Total	3,100,020.00	4,899,980.00	0.00	8,000,000.00

Registered capital is consistent with paid up capital stock. This increase of registered capital has been verified by Hangzhou Xiaoran Certified Public Accountants, after which capital registration verification reports numbered (2005) 38, 93 were produced on 16 May 2005 and 26 October 2005 respectively.

VII. Related parties and transactions

1. Residue of receivables and payables by related parties

Project	Residue	Percentage
Other receivables		
Zhejiang Matsuoka Industrial Co., Ltd.	14,929,887.40	99.34%
	14,929,887.40	99.34%

VIII. Contingency

None.

IX. Guarantee items

The Company provides a guarantee for Zhejiang Matsuoka Mechatronics Industry Co., Ltd.'s 35,000,000.00 loan.

X. Unadjustable items in the consolidated balance sheet

None.

XI. Other important issues

None.