



玖源生態農業科技（集團）有限公司

Ko Yo Ecological Agrotech (Group) Limited

(incorporated in the Cayman Islands with limited liability)

Interim Report

For the six months ended 30 June 2005

## **CHARACTERISTICS OF THE GROWTH ENTERPRISE MARKET (“GEM”) OF THE STOCK EXCHANGE OF HONG KONG LIMITED (THE “STOCK EXCHANGE”)**

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*This report, for which the directors of Ko Yo Ecological Agrotech (Group) Limited collectively and individually accept full responsibility, includes particulars given in compliance with the Rules Governing the Listing of Securities on GEM of the Stock Exchange for the purpose of giving information with regard to Ko Yo Ecological Agrotech (Group) Limited. The directors of Ko Yo Ecological Agrotech (Group) Limited, having made all reasonable enquiries, confirm that, to the best of their knowledge and belief: (i) the information contained in this report is accurate and complete in all material respects and not misleading; (ii) there are no other matters the omission of which would make any statement in this report misleading; and (iii) 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

For the six months ended 30 June 2005, unaudited turnover increased to approximately RMB315 million, which represents a growth of 58% as compared to the same period last year.

The sale quantities of the Group increased to approximately 235,000 tonnes, which represents an increase of 31% as compared to the six months ended 30 June 2004.

The sale quantities and turnover of BB Fertilizers of the Group increased to approximately 94,000 tonnes and RMB167 million, which represent growth of 61% and 116% respectively, as compared with the first half of 2004.

Unaudited profit attributable to shareholders of the Group was approximately RMB25.1 million for the six months ended 30 June 2005, which represents a growth of 185% as compared to that of the same period last year.

Unaudited basic earnings per share of the Group was approximately RMB5.96 cents for the six months ended 30 June 2005.

The Directors have resolved to pay an interim dividend at HK0.5 cent per share for the six months ended 30 June 2005.

**To all shareholders,**

The board of directors (the “Directors” or the “Board”) is pleased to present the unaudited condensed consolidated operating results of Ko Yo Ecological Agrotech (Group) Limited (the “Company”) and its subsidiaries (collectively, the “Group”) for the six months ended 30 June 2005.

**INTERIM DIVIDEND**

The Board has resolved to pay an interim dividend of HK0.5 cent per share for the six months ended 30 June 2005 to shareholders whose names appear on the register of members of the Company as at the close of business on 7 September 2005. The interim dividend will be paid to shareholders on 27 September 2005. The register of members of the Company will be closed from 5 September 2005 to 7 September 2005, both days inclusive, during which period no share transfer shall be effected. In order to qualify for the interim dividend, all instruments of transfers accompanied by the relevant share certificates must be lodged with the Company’s share registrar, Standard Registrars Limited, at G/F., Bank of East Asia Harbour View Centre, 56 Gloucester Road, Wanchai, Hong Kong for registration by no later than 4:00 p.m. on 2 September 2005.

## UNAUDITED CONDENSED CONSOLIDATED PROFIT AND LOSS ACCOUNT

For the three months and six months ended 30 June 2005

The unaudited results of the Group for the three months and six months ended 30 June 2005 together with the unaudited comparative figures for the corresponding periods in 2004 are as follows:

	Notes	Three months ended 30 June		Six months ended 30 June	
		2005 RMB'000	2004 RMB'000	2005 RMB'000	2004 RMB'000
Turnover	3	171,691	85,063	314,615	199,032
Cost of sales		(135,405)	(68,919)	(248,759)	(160,452)
Gross profit		36,286	16,144	65,856	38,580
Interest income		221	129	375	171
Distribution costs		(9,456)	(4,418)	(17,219)	(12,266)
Administrative expenses		(10,293)	(7,849)	(17,903)	(13,744)
Other income		926	150	2,368	712
Operating profit	4	17,684	4,156	33,477	13,453
Finance costs		(1,923)	(1,940)	(3,668)	(3,558)
Profit before taxation		15,761	2,216	29,809	9,895
Taxation	5	(2,606)	(994)	(4,632)	(1,084)
Profit after taxation		13,155	1,222	25,177	8,811
Minority interests		(18)	4	(29)	11
Profit attributable to shareholders		13,137	1,226	25,148	8,822
Basic earnings per share (RMB cents)	6	3.11	0.29	5.96	2.10
Diluted earnings per share	6	N/A	N/A	N/A	N/A
Declared dividends per share (HK cent)	7	Nil	Nil	0.5	0.3

## CONDENSED CONSOLIDATED BALANCE SHEET

As at 30 June 2005 and 31 December 2004

	Notes	(Unaudited) As at 30 June 2005 RMB'000	(Audited) As at 31 December 2004 RMB'000
Non-current assets			
Fixed assets		210,239	206,835
Long-term investment		1,000	1,000
Negative goodwill		—	(12,366)
		<u>211,239</u>	<u>195,469</u>
Current assets			
Inventories		49,207	51,037
Trade and other receivables	8	96,460	46,802
Pledged bank deposits		39,380	53,940
Cash and bank deposits		25,034	13,926
		<u>210,081</u>	<u>165,705</u>
Current liabilities			
Trade and other payables	9	137,538	69,229
Current portion of long-term loans, secured	10	21,400	—
Short-term bank loans, secured	10	54,900	95,430
		<u>213,838</u>	<u>164,659</u>
Net current (liabilities)/assets		<u>(3,757)</u>	<u>1,046</u>
Total assets less current liabilities		<u>207,482</u>	<u>196,515</u>
Finance by:			
Share capital		44,713	44,713
Reserves			
Declared interim/proposed final dividend		2,236	5,142
Others		136,517	101,239
Shareholders' funds		<u>183,466</u>	<u>151,094</u>
Minority interests		597	567
Non-current liabilities			
Long-term bank loans, secured	10	15,800	37,200
Provision for staff compensation		7,388	7,388
Deferred tax liabilities	11	231	266
		<u>23,419</u>	<u>44,854</u>
		<u>207,482</u>	<u>196,515</u>

## UNAUDITED CONDENSED CONSOLIDATED CASH FLOW STATEMENT

For the six months ended 30 June 2005 and 30 June 2004

	Six months ended 30 June	
	2005 RMB'000	2004 RMB'000
Net cash generated from operating activities	3,679	2,156
Interest paid	(3,668)	(3,558)
Net cash inflow/(outflow) from operating activities	<u>11</u>	<u>(1,402)</u>
Investing activities		
Purchases of fixed assets and payments for construction-in-progress	(8,617)	(10,976)
Proceeds from disposal of fixed assets	321	—
Payment of deposits for leased assets	—	(4,548)
Payment of other non-current assets	—	(966)
Dividends received from long-term investment	130	—
Interest received	375	171
Net cash outflow from investing activities	<u>(7,791)</u>	<u>(16,319)</u>
Net cash outflow before financing activities	<u>(7,780)</u>	<u>(17,721)</u>
Financing activities		
Decrease in pledged bank deposits	14,560	10,832
New loans payable	48,600	44,130
Repayment of bank loans	(39,130)	(43,130)
Dividends paid	(5,142)	(3,250)
Net cash inflow from financing activities	<u>18,888</u>	<u>8,582</u>
Increase/(decrease) in cash and cash equivalents	11,108	(9,139)
Cash and cash equivalents at 1 January	<u>13,926</u>	<u>34,517</u>
Cash and cash equivalents at 30 June	<u><u>25,034</u></u>	<u><u>25,378</u></u>

## UNAUDITED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

For the six months ended 30 June 2005 and 30 June 2004

	Share capital	Share premium	Merger reserve	Reserve fund	Enterprise expansion fund	Exchange difference	Retained earnings	Total
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
At 1 January 2004 (audited)	44,520	18,760	(22,041)	7,974	412	115	72,591	122,331
Net profit for the six months ended 30 June 2004	—	—	—	—	—	—	8,822	8,822
2003 Final dividend paid	—	—	—	—	—	—	(3,250)	(3,250)
At 30 June 2004	<u>44,520</u>	<u>18,760</u>	<u>(22,041)</u>	<u>7,974</u>	<u>412</u>	<u>115</u>	<u>78,163</u>	<u>127,903</u>
At 1 January 2005 (audited)	44,713	19,204	(22,041)	10,537	558	115	98,008	151,094
HKFRS 3	—	—	—	—	—	—	12,366	12,366
At 1 January 2005 (restated)	44,713	19,204	(22,041)	10,537	558	115	110,374	163,460
Net profit for the six months ended 30 June 2005	—	—	—	—	—	—	25,148	25,148
2004 Final dividend paid	—	—	—	—	—	—	(5,142)	(5,142)
At 30 June 2005	<u>44,713</u>	<u>19,204</u>	<u>(22,041)</u>	<u>10,537</u>	<u>558</u>	<u>115</u>	<u>130,380</u>	<u>183,466</u>



# NOTES TO THE UNAUDITED CONDENSED FINANCIAL STATEMENTS

## 1. Basis of preparation

The interim financial statements were unaudited, which have been prepared in accordance with the Hong Kong Accounting Standard (“HKAS”) 34 “Interim Financial Reporting” issued by the Hong Kong Institute of Certified Public Accountants (“HKICPA”) and the disclosure requirements set out in Chapter 18 of the Rules Governing the Listing of the Securities on Growth Enterprise Market of the Stock Exchange of Hong Kong Limited (the “GEM Listing Rules”).

## 2. Principal accounting policies

The HKICPA has undertaken to converge by 1 January 2005 all Hong Kong Financial Reporting Standards (“HKFRS”) with International Financial Reporting Standards (“IFRSs”) issued by the International Accounting Standards Board. As a result, the HKICPA had aligned HKFRS with the requirements of IFRSs in all materials respects as at 31 December 2004. The accounts have been prepared under the historical cost convention.

The adoption of HKFRS 2 has resulted in a change in accounting policy for employee share options. Prior to this, the provision of share options to employees did not result in a charge to the profit and loss account. Following the adoption of HKFRS 2, the fair value of share options at grant date is amortised over the relevant vesting periods to the profit and loss account. The Company has not applied this HKFRS retrospectively as share options of the Company granted after 7 November 2002 had vested at 1 January 2005.

The adoption of HKFRS 3 has resulted in a change in the accounting policy for negative goodwill. Prior to this, negative goodwill was recognized as income on a straight-line basis in the profit and loss account over the remaining weighted average useful life of assets acquired of 30 years. In accordance with the provision of HKFRS 3, the carrying amount of negative goodwill as at 1 January 2005 shall be derecognized with a corresponding adjustment to the opening balance of retained earnings, which increased the retained earnings by approximately RMB12,366,000.

The adoption of other new HKFRS does not result in substantial changes to the Group’s accounting policies except certain presentation and disclosure of the accounts will be affected.

### 3. Turnover

Turnover represents the net amounts received and receivable for chemical products and chemical fertilizers sold, less returns and allowances and value-added taxes, if applicable, during the six months period. The Group's revenues are primarily generated in the People's Republic of China (the "PRC").

Turnover consisted of the following products:

	Six months ended 30 June 2005 (unaudited)		Six months ended 30 June 2004 (unaudited)	
	RMB'000	%	RMB'000	%
BB Fertilizers	166,948	53.1%	77,256	38.8%
Sodium carbonate	51,596	16.4%	34,459	17.3%
Ammonium chloride	27,368	8.7%	17,706	8.9%
Urea	52,066	16.5%	65,724	33.0%
Ammonia	6,606	2.1%	3,887	2.0%
Ammonium bicarbonate	10,031	3.2%	—	—
	<u>314,615</u>	<u>100%</u>	<u>199,032</u>	<u>100%</u>

### 4. Operating profit

Operating profit is stated after crediting and charging the following:

	Six months ended 30 June	
	2005 RMB'000	2004 RMB'000
Crediting:		
Gain on disposal of fixed assets	<u>272</u>	<u>—</u>
Charging:		
Staff costs (including directors' emoluments)		
– Salaries, wages and other benefits	17,270	11,844
– Contributions to retirement scheme	1,521	802
Cost of inventories	248,759	160,452
Provision for doubtful receivables	461	130
Loss on disposal of fixed assets	88	—
Operating leases for buildings	519	503
Depreciation of fixed assets	5,213	4,056
Auditors' remuneration	<u>562</u>	<u>—</u>

## 5. Taxation

No provision for profits tax in the Cayman Islands, the British Virgin Islands or Hong Kong has been made, as the Group had no assessable profit arising in or derived from those jurisdictions during the six months ended 30 June 2005.

Chengdu Ko Yo Chemical Industry Co., Ltd. (“Chengdu Ko Yo Chemical”), Chengdu Ko Yo Compound Fertilisers Co., Ltd. (“Chengdu Ko Yo Compound”), Dezhou Ko Yo Compound Fertiliser Co., Ltd. (“Dezhou Ko Yo Compound”) and Dazhou City Dazhu Ko Yo Chemical Industry Co., Ltd. (“Dazhu Ko Yo Chemical”) were established as foreign investment enterprises in the PRC. They are subject to Enterprise Income Tax (“EIT”) at the rate of 15%, 15%, 33% and 15% respectively, and are entitled to full exemption from EIT in the first two profitable years and a 50% reduction for the next three years thereafter.

The preferential EIT rate applicable for Chengdu Ko Yo Chemical in 2005 is 15%. Pursuant to relevant taxation regulations of the PRC and as approved by the local taxation bureau, Chengdu Ko Yo Chemical was entitled to deduct from its EIT expenses for an amount of 40% of cost of certain machinery acquired from the PRC enterprises, which are local machinery suppliers and unrelated to the Group. Accordingly, EIT provision made for Chengdu Ko Yo Chemical for the six months ended 30 June 2005 was RMB4,027,000.

The EIT provision made for and preferential EIT rate applicable to Chengdu Ko Yo Compound for the six months ended 30 June 2005 are approximately RMB640,000 and 7.5%.

Dezhou Ko Yo Compound and Dazhu Ko Yo Chemical did not have assessable profit for the six months ended 30 June 2005.

The amount of taxation charged to the unaudited condensed consolidated profit and loss account represents:

	<b>Six months ended 30 June</b>	
	<b>2005</b>	2004
	<b>RMB'000</b>	RMB'000
EIT in the PRC	<b>4,667</b>	1,137
Deferred tax (Note 11)	<b>(35)</b>	(53)
	<b><u>4,632</u></b>	<u>1,084</u>

## 6. Earnings per share

The calculation of basic earnings per share for the three months and the six months ended 30 June 2005 and 2004 is based on the unaudited consolidated profit attributable to shareholders of approximately RMB13,137,000 and RMB25,148,000 (2004: RMB1,226,000 and RMB8,822,000) for relevant periods and on the 421,820,000 (2004: 420,000,000) ordinary shares in issue. Diluted earning per share is not presented as there was no dilutive potential ordinary share.

## 7. Dividend

The Board has resolved the payment of an interim dividend at HK0.5 cent per share to the shareholders whose names appear on the register of members of the Company as at the close of business on 7 September 2005. The dividend will be payable on 27 September 2005. The dividend as declared should not be taken as an indication of the level of profit or dividend for the full year.

## 8. Trade and other receivables

	(Unaudited)	(Audited)
	As at	As at
	30 June 2005	31 December 2004
	RMB'000	RMB'000
Trade receivables	53,198	10,642
Prepayments, purchase deposits and other deposits	31,946	25,983
Notes receivable	1,561	505
Other receivables	9,755	9,672
	<u>96,460</u>	<u>46,802</u>

In general, the credit terms granted by the Group ranged from 0 to 3 months. The aging analysis of trade receivables is as follows:

	(Unaudited)	(Audited)
	As at	As at
	30 June 2005	31 December 2004
	RMB'000	RMB'000
Aged:		
Less than 3 months	47,102	8,844
More than 3 months but not exceeding 1 year	8,342	1,209
More than 1 year but not exceeding 2 years	—	2,127
More than 2 years but not exceeding 3 years	—	322
More than 3 years	441	366
	<u>55,885</u>	<u>12,868</u>
Less: provision for doubtful receivables	(2,687)	(2,226)
	<u>53,198</u>	<u>10,642</u>

## 9. Trade and other payables

	(Unaudited) As at 30 June 2005 RMB'000	(Audited) As at 31 December 2004 RMB'000
Due to related companies	124	124
Trade payables	28,017	18,796
Notes payable	45,501	8,770
Deposits from customers	24,629	17,225
Accruals and other payables	39,267	24,314
	<u>137,538</u>	<u>69,229</u>

The aging analysis of trade payables is as follows:

	(Unaudited) As at 30 June 2005 RMB'000	(Audited) As at 31 December 2004 RMB'000
Aged:		
Less than 1 year	27,940	18,559
More than 1 year but not exceeding 2 years	61	178
More than 2 years but not exceeding 3 years	—	59
More than 3 years	16	—
	<u>28,017</u>	<u>18,796</u>

## 10. Bank loans

	(Unaudited) As at 30 June 2005 RMB'000	(Audited) As at 31 December 2004 RMB'000
Short-term bank loans, secured	<u>54,900</u>	<u>95,430</u>
Long-term bank loans repayable:		
Less than 1 year	21,400	—
More than 1 year but not exceeding 2 years	10,000	28,400
More than 2 years but not exceeding 5 years	5,800	8,800
More than 5 years	<u>—</u>	<u>—</u>
	37,200	37,200
Amounts due within 1 year included in current liabilities	<u>(21,400)</u>	<u>—</u>
	<u>15,800</u>	<u>37,200</u>

As at 30 June 2005, bank loans of the Group were generally secured by certain fixed assets of the Group. These bank loans bear interest at the rate of 5.86% to 6.98% (2004: 4.87% to 6.98%) per annum.

## 11. Deferred tax liabilities

Deferred tax liabilities is calculated in full on temporary differences under the liability method using the taxation rates applicable to the respective companies. The movement in deferred tax assets and liabilities (prior to offsetting of balances within the same taxation jurisdiction) during the relevant periods is as follows:

	Deferred tax liabilities		Deferred tax assets		Total	
	Difference in tax depreciation		Impairment of assets			
	30 June 2005 RMB'000	31 December 2004 RMB'000	30 June 2005 RMB'000	31 December 2004 RMB'000	30 June 2005 RMB'000	31 December 2004 RMB'000
Beginning of the year/period	624	624	(358)	(237)	266	387
Credited to profit and loss account	<u>—</u>	<u>—</u>	<u>(35)</u>	<u>(121)</u>	<u>(35)</u>	<u>(121)</u>
End of the year/period	<u>624</u>	<u>624</u>	<u>(393)</u>	<u>(358)</u>	<u>231</u>	<u>266</u>

## MANAGEMENT DISCUSSION AND ANALYSIS

### Financial Performance

For the six months ended 30 June 2005, the Group recorded a turnover of approximately RMB315 million, representing an increase of approximately 58% as compared with approximately RMB199 million for the same period last year. Profit attributable to shareholders was approximately RMB25.1 million (2004: approximately RMB8.8 million), which represented a growth of 185% compared with previous year, and basic earnings per share were approximately RMB5.96 cents (2004: approximately RMB2.1 cents).

During the period under review, the total sale quantities of the Group reached 235,000 tonnes (2004: 180,000 tonnes), which represented a growth of approximately 31%, in which sale volume of BB Fertilizers increased by 61% as compared to the corresponding period of last year.

The growth in turnover for the period under review was attributable to the increases in production quantity and selling prices of the Group's principal products. The reasoning behind the increases included the continuous increase in oil price drove up the price of chemical fertilizers in the PRC and the increased fertilizers consumption for the domestic peasants owing to the government incentives in respects of tax, allowance and also increase of price of produce.

For the period under review, the gross profit margin of the Group increased by approximately 1.5% to 20.9% compared with the corresponding period last year. Cost of sales amounted to approximately RMB249 million, representing an increase of 55% as compared to corresponding period of last year. Distribution costs increased by approximately 40%, and the administrative expenses increased 30% as compared with last year.

### Business Review

During the period under review, the Group has realized the development plan for the first half of the year, i.e. to aggressively explore the growth potential for BB Fertilizers, which has become the principal and star product of the Group. On the other hand, the Group continued to focus on maintaining relationship with its long-term customers via selling sodium carbonate, ammonium chloride, urea, and ammonia and therefore the income stream for these products is stable.

## MANAGEMENT DISCUSSION AND ANALYSIS *(Continued)*

### **Business Review** *(Continued)*

#### *BB Fertilizers*

For the six months ended 30 June 2005, turnover and sale volume of BB Fertilizers achieved satisfactory growth as compared with the same period last year. BB Fertilizers has become the major income source of the Group, and contributed approximately 53% to the Group's total turnover. The total sale quantities of BB Fertilizers were approximately 94,000 tonnes, which represented a 61% growth compared to the same period last year (2004: 58,000 tonnes). Compare to the same period last year, the average selling prices of the BB Fertilizers increased by approximately 34% to approximately RMB1,783 per tonne.

BB Fertilizers are the compound fertilizers with soil formula, which has the advantages over traditional fertilizers on selected crops by improving their sizes, weight, taste, color, appearance and nutrition value. The Group's BB Fertilizers consist of different types specially designed for rice, wheat, vegetable, cotton, corn, sugar cane, garlic, tobacco, peasants, watermelon, fruit trees, melon and eggplant, chili, orange and tangerine, rhizoma dioscoreae, tea, mulberry tree and Chinese medicine, etc.

The Group's BB Fertilizers are entirely accommodative soil formula with high degree of absorption. Also, it is more environmental-friendly, more effective than ordinary fertilizers, therefore, higher cost-efficiency can be achieved. It is widely recognized by peasants and has gained much word of mouth. The growth of BB Fertilizers was driven by effectiveness of the marketing network established and brand promotion activities, as well as the macro environment brought about by the central government and the increasing awareness of the market towards compound fertilizers.

The Group highly emphasized on building an effective marketing and distribution network nationwide. For the period under review, the network demonstrated its power in boosting the product demand by end-users. The network in fact is a one-stop marketing network integrating with production, supply, distribution and after-sales services via the consolidation of distribution channels of agriculture distributors, companies and stations. The Group also divided and managed the farmland into different zones. The Group launched an 'On-site Training Programme' throughout its network in order to educate the peasants to use BB Fertilizers in the most effective way. The network at present covers 20 provinces and 3 autonomous regions and sales terminals reach more than 7,100.



## MANAGEMENT DISCUSSION AND ANALYSIS *(Continued)*

### **Business Review** *(Continued)*

#### *BB Fertilizers (Continued)*

In addition, the Group increased its effort in promoting the brand through various promotion activities. Such as, the Group co-organized First China BB Fertilizers Forum at Beijing on 25 June 2005 and National Development and Reform Commission, Ministry of Commerce, Ministry of Agriculture, State Administration for Industry & Commerce, State Administration of Quality Supervision, Inspection and Quarantine have participated the forum. The forum was themed of “the market leads the healthy development of the industry” and it effectively drove the industry growth and competition in order. Through which, the Group has successfully established its position as one of market leaders in the BB Fertilizers industry in the PRC.

In line with the increasing market awareness towards compound fertilizers, the demand for compound fertilizers and BB Fertilizers grew rapidly. According to China Fertilizer Information Net, consumption of chemical compound fertilizers increased 30% in 2004 compared with the corresponding increase of 13.9% in 2003. The central government strongly promotes balance utilization of fertilizers boosting the rapid growth for chemical compound fertilizers.

#### *Other products*

Turnover derived from sodium carbonate and ammonium chloride increased by 50% and 55% respectively as compared to previous year, which accounted for approximately 16.4% and 8.7% of the Group’s total turnover respectively. The net sales of urea decreased by 21% to RMB52 million in the period under review as compared to the same period in last year, which accounted for 16.5% of the Group’s total net sales. Excluding the export sales of urea from the comparative figures last year, turnover of urea, in fact, increased by 32% as compared to the corresponding period of last year.

## MANAGEMENT DISCUSSION AND ANALYSIS *(Continued)*

### **Business Review** *(Continued)*

#### *Other products (Continued)*

The chemical fertilizer industry is beneficial by the supportive government policies towards agriculture industry. According to the promulgation of document [2005] 87 issued on 23 May 2005 by the National Bureau of Tax from Ministry of Finance, the value-added tax for urea products manufactured by domestic enterprises will be temporarily waived starting from 1 July 2005, following the 50% refund policy of value-added tax commencing on 1 January 2004. It will pose a positive impact on the selling price of urea products. The value-added tax rate for urea products previously was 13%. Also, the beneficiary measures such as the waiver or reduction of agricultural tax and produce plantation allowance for peasants stimulate the plantation incentive of the peasants as well as their demand for chemical fertilizers.

The newly acquired factory, Dazhu Ko Yo Chemical was still under consolidation stage in the first half of 2005. During the period under review, Dazhu Ko Yo Chemical generated turnover of approximately RMB32 million. The Board expects that the factory will start the significant contribution in the second half of 2005 and become the future growth momentum of the Group.

### **Prospects**

Large granule of urea is one of major raw material of BB Fertilizers of the Group. The Group currently procures large granule of urea in other provinces as there is no stable supply in Sichuan province. In order to meet the raw material supply for the growth of BB Fertilizers and further reduction in the production cost, the Group will restart the plan to upgrade the existing production line of urea as stated in Future Plans of the prospectus of the Company dated 30 June 2003 (the "Prospectus"). The production cost of BB Fertilizers will be reduced as it saves the transportation cost of large granule of urea approximately RMB150 per tonne. The plan will start in the second half of 2005 and estimated completion in the first quarter of 2006.

Meanwhile, following the growth trend of BB Fertilizers, in order to meet the increasing demand in the coming year, the Group will restart the plan of new production plant to increase the total production capacity of BB Fertilizers to 600,000 tonnes as stated in Future Plans of the Prospectus. The Group will establish a factory in Laixi city, Qingdao city, Shandong province, the PRC. Comparing with the existing factory of Dezhou Ko Yo Compound, the new factory site has better geographical advantages for transportation and further potential development. This new production plant is expected to commence production before the peak season of BB Fertilizers in March 2006 in order to cushion the rapid growth period. The existing production facilities of Dezhou Ko Yo Compound will be absorbed into the new factory plant in due course.

## MANAGEMENT DISCUSSION AND ANALYSIS (Continued)

### Prospects (Continued)

During the period under review, the Group hired professional marketing consultants to overall evaluate and design the sales and marketing campaigns of BB Fertilizers. The campaigns will be themed of selling with service and brand name. The Group's goal is to further boost the sales quantity of BB Fertilizers with national brand name in near future.

## COMPARISON OF BUSINESS OBJECTIVES WITH ACTUAL BUSINESS PROGRESS

On 10 July 2003, the Company obtained net proceeds, after deducting all relevant share issue expenses, of approximately HK\$28.4 million from the new issue of shares by way of public offer and placing. Up to 30 June 2005, the Group has applied the net proceeds as follows:

	Use of proceeds extracted from the Prospectus HK\$ million	Actual amount used up to 30 June 2005 HK\$ million	Remaining net Proceeds HK\$ million
Establishment of additional production facilities and purchase of equipment for BB Fertilizers	18	18	—
Development of new products, product research and assessment	5	2.1	2.9
Advertising and promotion of new products and expansion of the Group's sales force	5	5	—
Total	<u>28</u>	<u>25.1</u>	<u>2.9</u>

The remaining net proceeds as at 30 June 2005 was approximately HK\$2.9 million, which have been placed as interest bearing deposits in banks in the PRC.

## COMPARISON OF BUSINESS OBJECTIVES WITH ACTUAL BUSINESS PROGRESS *(Continued)*

Comparison of the business objectives set out in the Prospectus with the actual business progress for the period from 1 January 2005 to 30 June 2005 is as follows:

### **Business objectives as stated in Prospectus**

### **Actual business progress**

*Expansion of production capacity/upgrading of its production facilities*

To increase the production volume of BB Fertilizers of new production plant with total production capacity of 600,000 tonnes per annum

The Board has decided to restart this plan in Laixi city, Qingdao city, Shandong province, the PRC. Approximately RMB 10 million will be invested in the coming six months according to original plan in the Prospectus. Completion is expected in the first quarter of 2006

To upgrade the production line for urea by purchasing additional compressor machines, pumps and heat exchangers, with the aim of producing larger granules of urea

The Board has decided to restart this plan with an investment of approximately RMB 5 million, which will be financed through internal resources. Completion is expected in the first quarter of 2006

To upgrade the production line for ammonium chloride in granule form with a production capacity of 80,000 tonnes per annum

The Board has decided to temporarily postpone the plan of upgrading the production line of ammonium chloride until the completion of upgrading urea production line

To complete the construction of a production plant for BB Fertilizers to increase total production capacity to 800,000 tonnes

The Board has decided to temporarily postpone the plan as the existing plan of BB Fertilizers with production capacity of 600,000 tonnes will satisfy the foreseeable growth of sales volume in 2006. The Board has reserved resources in the new production plant in Laixi city for further increase in production capacity to 800,000 tonnes in future

## COMPARISON OF BUSINESS OBJECTIVES WITH ACTUAL BUSINESS PROGRESS *(Continued)*

### Business objectives as stated in Prospectus

### Actual business progress

#### *Research and development of new products*

To develop and launch a new series of BB Fertilizers

No new series of BB Fertilizers developed as the efforts focused on marketing BB Fertilizers

To identify new research projects

The Board has decided to postpone the plan in order to concentrate the resources for marketing BB Fertilizers

To conduct research and development of multi-purpose BB Fertilizers

The Board has decided to postpone the plan in order to concentrate the resources for marketing BB Fertilizers

#### *Marketing and brand building of the Group's products*

To advertise the brand image of the Group's products on television channels in the PRC

The Group will carry out different channels of advertising in the second half of 2005

To organize and attend seminars and tradeshow relating to the chemical fertilizers industry

The Group co-organized First China BB Fertilizers Forum at Beijing on 25 June 2005

#### *Human resources*

To increase production staff, marketing staff, technical staff and agricultural service staff

Compared with 2004, the Group additionally recruited 66 production staff and 10 marketing staff

## LIQUIDITY, FINANCIAL RESOURCES AND CAPITAL STRUCTURE

As at 30 June 2005, the Group had net current liabilities of approximately RMB3,757,000. Current assets as at 30 June 2005 comprised cash and bank deposits of approximately RMB25,034,000, pledged bank deposits of approximately RMB39,380,000, inventories of approximately RMB49,207,000, trade and other receivables of approximately RMB96,460,000. Current liabilities as at 30 June 2005 comprised short-term loans and current portion of long-term bank loans of approximately RMB76,300,000 and trade and other payables of approximately RMB137,538,000.

### CAPITAL COMMITMENTS

As at 30 June 2005, the Group had outstanding capital commitments of approximately RMB4,568,000.

### FINANCIAL RESOURCES

As at 30 June 2005, the Group had bank balances of approximately RMB25,034,000 and standby bank facilities of approximately RMB30,000,000. The Company intends to finance the Group's future operations, capital expenditure and other capital requirements with the existing bank balances and standby bank facilities.

### GEARING RATIO

The Group's gearing ratios were 56% and 58% as at 30 June 2005 and 31 December 2004 respectively. The gearing ratios were calculated based on total liabilities over total assets as at the balance sheet dates.

### CONTINGENT LIABILITIES

The Group had no significant contingent liabilities as at 30 June 2005.

### MATERIAL ACQUISITIONS/DISPOSALS

The Group had no material acquisitions/disposals during the six months ended 30 June 2005 and it is the same for the comparative six months ended 30 June 2004.

## SEGMENTAL INFORMATION

All the Group's activities are conducted in the PRC and are within the same business segment. Accordingly, neither analysis by geographical segments nor analysis by business segments is presented.

## DETAILS OF FUTURE PLANS FOR MATERIAL INVESTMENT OR CAPITAL ASSETS

Other than the Future Plans of the Prospectus, the Directors do not have any future plans for material investment or capital assets.

## EMPLOYEE INFORMATION

As at 30 June 2005, the Group had 1,975 (2004: 1,857) employees, comprising 6 (2004: 8) in management, 156 (2004: 115) in finance and administration, 1,717 (2004: 1,651) in production, 86 (2004: 76) in sales and marketing and 10 (2004: 7) in research and development, 1,969 (2004: 1,851) of these employees were located in the PRC and 6 (2004: 6) were located in Hong Kong.

## CHARGES ON THE GROUP'S ASSETS

As at 30 June 2005, certain land use rights and buildings with a total net book value of approximately RMB68,389,000 (2004: RMB69,116,000), plant and machinery with a total net book value of approximately RMB22,675,000 (2004: RMB23,675,000) and bank deposits approximately RMB39,380,000 (2004: RMB53,940,000) were pledged as collateral for the Group's bank loans and notes payable.

## FOREIGN EXCHANGE EXPOSURE

Since most of the income and expenditure of the Group were received and paid in local currencies in the countries and places where the Group operates, the Directors do not consider that the Group was significantly exposed to any foreign currency exchange risk.

## SHARE OPTION SCHEME

Share options were granted to certain directors, employees and consultant of the Company or its subsidiaries under the share option scheme adopted by written resolutions of shareholders on 10 June 2003 (the “Scheme”), which was amended by an ordinary resolution duly passed at an extraordinary general meeting by the Company’s shareholders on 28 July 2004. A summary of the principle terms and conditions of the Scheme are set out in the section headed “Share Option Scheme” in Appendix IV of the Prospectus and amendments details of the Scheme are set out in the circular of the Company dated 12 July 2004.

Details of options granted by the Company pursuant to the Scheme and the outstanding as at 30 June 2005 were disclosed in the following table:

	Number of options			Held at 30 June 2005	Exercise price HK\$	Grant date	Exercisable from	Exercisable until
	Held at 1 January 2005	Granted during the period	Exercised during the period					
<b>Directors</b>								
Chi Chuan	4,200,000	—	—	4,200,000	0.62	23 September 2003	23 September 2004	22 September 2013
Man Au Vivian	3,800,000	—	—	3,800,000	0.62	23 September 2003	23 September 2004	22 September 2013
Li Shengdi	4,200,000	—	—	4,200,000	0.62	23 September 2003	23 September 2004	22 September 2013
Hu Xiaoping	400,000	—	—	400,000	0.62	23 September 2003	23 September 2004	22 September 2013
Woo Che-wor, Alex	400,000	—	—	400,000	0.62	23 September 2003	23 September 2004	22 September 2013
<b>Employees</b>	12,200,000	—	—	12,200,000	0.62	23 September 2003	23 September 2004	22 September 2013
<b>Total</b>	<b>25,200,000</b>	<b>—</b>	<b>—</b>	<b>25,200,000</b>				



## DISCLOSURE OF INTERESTS

### (a) Interests of the Directors in the Company

As at 30 June 2005, the interests and short positions of the Directors and chief executives in the shares, underlying shares or debentures of the Company and its associated corporations (within the meaning of Part XV of the Securities and Futures Ordinance (the “SFO”)), which are required (a) 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 (b) to be recorded in the register required to be kept under section 352 of the SFO; or (c) to be notified to the Company and the Stock Exchange pursuant to the minimum standards of dealings by directors referred to in Rule 5.46 of the GEM Listing Rules were as follows:

#### (i) Long positions in the shares and the underlying shares of the Company

Name of Director	Type of shares	Capacity	Aggregate long position in shares and underlying shares	Approximate percentage of interests in the issued share capital
Li Weiruo	Personal	Beneficial owner	206,440,000	48.94
Yuan Bai	Personal	Beneficial owner	35,448,000	8.40
Chi Chuan	Personal	Beneficial owner	16,728,000 <i>(Note)</i>	3.97
Man Au Vivian	Personal	Beneficial owner	10,064,000 <i>(Note)</i>	2.39
Li Shengdi	Personal	Beneficial owner	4,200,000 <i>(Note)</i>	1.00
Hu Xiaoping	Personal	Beneficial owner	400,000 <i>(Note)</i>	0.10
Woo Che-wor, Alex	Personal	Beneficial owner	400,000 <i>(Note)</i>	0.10

## DISCLOSURE OF INTERESTS *(Continued)*

### (a) Interests of the Directors in the Company *(Continued)*

#### (i) Long positions in the shares and the underlying shares of the Company *(Continued)*

*Note:* Long position in the underlying shares of the Company

Details of the share options granted to Directors during the period are as follows:

Name of Director	Date of Grant	Outstanding as at 1 January 2005	Number of share options				Outstanding as at 30 June 2005	Exercisable period	Exercise price HK\$
			Granted during the period	Exercised during the period	Cancelled during the period				
Chi Chuan	23 September 2003	4,200,000	—	—	—	4,200,000	23 September 2004 - 22 September 2013	0.62	
Man Au Vivian	23 September 2003	3,800,000	—	—	—	3,800,000	23 September 2004 - 22 September 2013	0.62	
Li Shengdi	23 September 2003	4,200,000	—	—	—	4,200,000	23 September 2004 - 22 September 2013	0.62	
Hu Xiaoping	23 September 2003	400,000	—	—	—	400,000	23 September 2004 - 22 September 2013	0.62	
Woo Che-wor, Alex	23 September 2003	400,000	—	—	—	400,000	23 September 2004 - 22 September 2013	0.62	

## DISCLOSURE OF INTERESTS *(Continued)*

### (a) Interests of the Directors in the Company *(Continued)*

#### (ii) Interests in shares of an associated corporation of the Company

Name of Director	Name of company	Number and description of shares	Capacity	Type of interest	Approximate percentage of holding
Li Weiruo	Ko Yo Development Co., Limited ("Ko Yo Hong Kong") <i>(Note)</i>	2,100,000 non-voting deferred shares	Beneficial owner	Personal	70
Yuan Bai	Ko Yo Hong Kong	420,000 non-voting deferred shares	Beneficial owner	Personal	14
Chi Chuan	Ko Yo Hong Kong	120,000 non-voting deferred shares	Beneficial owner	Personal	4
Man Au Vivian	Ko Yo Hong Kong	60,000 non-voting deferred shares	Beneficial owner	Personal	2

*Note:* a wholly-owned subsidiary of the Company

## DISCLOSURE OF INTERESTS *(Continued)*

### (a) Interests of the Directors in the Company *(Continued)*

(iii) Short positions in the shares of an associated corporation of the Company

Name of Director	Capacity	Name of company	Number and description of shares	Aggregate percentage of holding of such class
Li Weiruo	Beneficial owner	Ko Yo Hong Kong	2,100,000 non-voting deferred shares	70
Yuan Bai	Beneficial owner	Ko Yo Hong Kong	420,000 non-voting deferred shares	14
Chi Chuan	Beneficial owner	Ko Yo Hong Kong	120,000 non-voting deferred shares	4
Man Au Vivian	Beneficial owner	Ko Yo Hong Kong	60,000 non-voting deferred shares	2

## DISCLOSURE OF INTERESTS *(Continued)*

### **(b) Interests of the substantial shareholders in the Company**

As at 30 June 2005, there was no substantial shareholder (not being a Director or a chief executive of the Company) who had any interests or short positions in the shares or underlying shares of the Company which are required to be notified to the Company and the Stock Exchange under Divisions 2 and 3 of Part XV of the SFO and recorded in the register required to be kept under section 336 of the SFO, and who were directly or indirectly deemed to be interested in 10% or more of the nominal value of any class of share capital carrying rights to vote in all circumstances at general meetings of the Company.

### **(c) Interests of other persons in the Company**

As at 30 June 2005, there was no person or company (not being a Director or a chief executive of the Company) who had any interests or short positions in the shares or underlying shares of the Company which are required to be notified to the Company and the Stock Exchange under Divisions 2 and 3 of Part XV of the SFO and recorded in the register required to be kept under section 336 of the SFO, and who were directly or indirectly deemed to be interested in 5% or more of the nominal value of any class of share capital carrying rights to vote in all circumstances at general meetings of the Company.

## DIRECTORS' INTEREST IN COMPETING BUSINESS

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

## COMPLIANCE ADVISER'S INTERESTS

Pursuant to a compliance adviser agreement dated 9 July 2003 between the Company and Guotai Junan Capital Limited (“Guotai Junan”), Guotai Junan has been appointed as the compliance adviser of the Company as required under the GEM Listing Rules at a fee for the remainder of the financial year of the Company ending 31 December 2003 and for a period of two years thereafter expiring on 31 December 2005.

As confirmed by Guotai Junan, as at 30 June 2005, neither Guotai Junan, their directors, employees nor any of their respective associates (as defined under the GEM Listing Rules) have any interest in any securities of the Company or any of its associates.

## CODE OF CONDUCT REGARDING SECURITIES TRANSACTIONS BY DIRECTORS

During the six months ended 30 June 2005, the Company has adopted a code of conduct regarding securities transactions by directors on terms no less exacting than the required standard of dealings set out in Rules 5.48 to 5.67 of the GEM Listing Rules. The Company also had made specific enquiry of all directors and the Company was not aware of any non-compliance with the required standard of dealings and its code of conduct regarding securities transactions by directors.

## AUDIT COMMITTEE

The Company established an audit committee on 10 June 2003 with written terms of reference in compliance with Rules 5.28 to 5.33 of the GEM Listing Rules. The primary duties of the audit committee are to review and supervise the financial reporting process and internal control system of the Company and the Group and provide advice and comments to the Directors. The audit committee has three members comprising the three independent non-executive directors, namely, Mr. Hu Xiaoping, Mr. Woo Che-wor, Alex and Mr. Qian Laizhong.

The audit committee has reviewed with management the accounting principles and practices adopted by the Company and the Group and discussed internal controls and financial reporting matters including a review of the unaudited interim financial statements accounts of the Company and the Group for the six months ended 30 June 2005.

## CORPORATE GOVERNANCE

The Board practices and procedures set out in Rules 5.35 to 5.45 of the GEM Listing Rules were replaced by the Code on Corporate Governance Practices (the “Code”) as set out in Appendix 15 of the GEM Listing Rules, which has been effective for accounting period commencing on or after 1 January 2005. Appropriate actions have been taken by the Company for complying with the Code on Corporate Governance Practices. Except A2.1, D1.1 and D1.2 of the Code, the Group has complied with the code provisions set out in the Code. The Group will complete the separation of the roles of chairman and chief executive officers with clear division of their responsibilities, and formalizing the functions of the Board and management as soon as possible.

## PURCHASE, SALE OR REDEMPTION OF SHARES

Neither the Company nor any of its subsidiaries purchased, sold or redeemed any of the Company’s listed shares during the period under review.

By Order of the Board

**Li Weiruo**

*Chairman*

Chengdu, the PRC, 10 August 2005