

## NOTES TO THE CONDENSED FINANCIAL STATEMENTS

### 1. Principal accounting policies

The unaudited condensed financial statements have been prepared under the historical cost convention and in accordance with the Statement of Standard Accounting Practice No. 25 "Interim financial reporting" issued by the Hong Kong Society of Accountants ("HKSA") and Appendix 16 of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the "Listing Rules").

The accounting policies adopted are consistent with those followed in the Group's annual financial statements for the year ended 31st December 2000 except that as a result of adoption of the revised Statement of Standard Accounting Practice No. 9 "Events after the balance sheet date" ("SSAP 9") issued by the HKSA, dividends proposed after the balance sheet date are no longer recognised as liabilities while dividends income proposed or declared by subsidiaries after the balance sheet date are no longer recognised as income at the balance sheet date but recognised when they are proposed or declared. This change in accounting policy has been applied retrospectively and comparative figures have been restated. As a result, the retained earnings of the Group as at 1st January 2001 has been increased by HK\$20,259,000.

### 2. Segment information

An analysis of the Group's turnover and results by operating activity and geographical segment is as follows:

	Turnover		Segment result	
	For the six months ended 30th June 2001		For the six months ended 30th June 2001	
	2000	2000	2001	2000
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
<b>Business Segments:</b>				
Sales of rare earth products	<b>212,133</b>	169,272	<b>68,911</b>	52,824
Sales of refractory products	<b>120,926</b>	72,859	<b>37,591</b>	28,043
	<b>333,059</b>	242,131	<b>106,502</b>	80,867
Unallocated corporate items			<b>(20,999)</b>	(18,935)
Profit from operations			<b>85,503</b>	61,932
<b>Geographical Segments:</b>				
The People's Republic of China ("PRC")	<b>174,471</b>	126,602	<b>55,168</b>	44,306
The United States	<b>50,922</b>	39,271	<b>16,542</b>	12,255
Japan	<b>86,314</b>	63,427	<b>27,856</b>	20,302
Others	<b>21,352</b>	12,831	<b>6,936</b>	4,004
	<b>333,059</b>	242,131	<b>106,502</b>	80,867
Unallocated corporate items			<b>(20,999)</b>	(18,935)
Profit from operations			<b>85,503</b>	61,932

**3. Depreciation**

During the period, depreciation of HK\$9,386,000 (2000: HK\$4,413,000) was charged in respect of the Group's fixed assets.

**4. Interest on borrowings**

During the period, interest on borrowings of HK\$1,275,000 (2000: HK\$1,656,000) was charged before profit before taxation.

**5. Taxation**

No provision for Hong Kong profits tax has been made as the Group had no assessable profits in Hong Kong during both periods.

Pursuant to the relevant tax laws in the PRC, the Group is exempted from enterprise income tax during the period from 1st January 2000 to 31st December 2001.

**6. Dividends**

During the period, a final dividend of the previous year at HK\$0.03 (2000: HK\$0.02) per ordinary share was declared and paid.

Subsequent to 30th June 2001, the Board has resolved to declare an interim dividend at HK\$0.02 (2000: HK\$0.01) per ordinary share amounting to a total of HK\$16,289,000 (2000: HK\$6,018,000).

The amount of interim dividend has been calculated on the basis of 814,453,059 shares in issue as at 10th September 2001.

**7. Earnings per share**

Basic earnings per share is calculated based on the profit attributable to shareholders of approximately HK\$78,623,000 (2000: HK\$56,949,000) for the period and the weighted average number of 686,036,000 shares (2000: 600,000,000 shares) in issue during the period.

Diluted earnings per share for the period ended 30th June 2000 is calculated based on the adjusted profit attributable to shareholders of approximately HK\$57,036,000 after taking into consideration the potential dilution effect of conversion of convertible bonds and exercise of share options issued, and the weighted average number of 604,760,000 shares having been adjusted to reflect all potential dilution effect. It is assumed that the proceeds from exercise of share options were placed on Hong Kong dollars fixed deposit earning interest of 4.5% per annum. There is no diluted earnings per share shown for the period ended 30th June 2001 as there were no dilutive potential ordinary shares as at 30th June 2001.

**8. Accounts receivable and other receivables**

The Group offers an average credit term of 30 to 90 days to trade customers.

As at the end of the period, accounts receivable and other receivables comprised:

	<b>30th June 2001 HK\$'000</b>	31st December 2000 HK\$'000
Accounts receivable	<b>109,569</b>	98,271
Other receivables	<b>11,937</b>	10,165
Less: Provision for bad and doubtful debts	<b>(17,461)</b>	(17,095)
	<b>104,045</b>	91,341

The aging analysis of accounts receivable is as follows:

	<b>30th June 2001 HK\$'000</b>	31st December 2000 HK\$'000
Current to 6 months	<b>88,836</b>	74,228
6 months to 1 year	<b>4,338</b>	4,889
1 year to 2 years	<b>668</b>	10,763
Over 2 years	<b>15,727</b>	8,391
	<b>109,569</b>	98,271

**9. Accounts payable**

The aging analysis of accounts payable as at the end of the period is as follows:

	<b>30th June 2001 HK\$'000</b>	31st December 2000 HK\$'000
Current to 6 months	<b>22,682</b>	19,606
6 months to 1 year	<b>557</b>	2,450
1 year to 2 years	<b>855</b>	1,273
Over 2 years	<b>302</b>	-
	<b>24,396</b>	23,329

## 10. Convertible bonds

During the period ended 30th June 2000, the Company issued convertible bonds with an aggregate principal amount of US\$5,000,000, equivalent to HK\$39,000,000, to a third party. US\$600,000, equivalent to HK\$4,680,000, were converted as at 31st December 2000. During the period ended 30th June 2001, the remaining US\$4,400,000, equivalent to HK\$34,320,000, of the bonds were converted into 29,959,000 ordinary shares of the Company. None of the bonds were converted during the period ended 30th June 2000.

In addition to the bonds, the Company also granted options to the third party to subscribe for 4,000,000 newly issued ordinary shares of the Company. All the options were exercised and 4,000,000 new ordinary shares of the Company were issued during the period ended 30th June 2001.

## 11. Share capital

	No. of shares '000	Amount HK\$'000
<i>Authorised:</i>		
Ordinary share of HK\$0.10 each	1,000,000	100,000
<i>Issued and fully paid:</i>		
At 1st January 2001	675,294	67,529
Shares issued upon conversion of bonds	29,959	2,996
Shares issued upon exercise of options	4,000	400
<b>At 30th June 2001</b>	<b>709,253</b>	<b>70,925</b>

## 12. Reserves

	Share premium HK\$'000	Capital reserve HK\$'000	Statutory reserves HK\$'000	Exchange transaction reserve HK\$'000	Retained profit HK\$'000	Total HK\$'000
As at 1st January 2001,						
as previously reported	130,958	32,837	20,235	3,218	245,817	433,065
Effect of adopting SSAP 9	-	-	-	-	20,259	20,259
As at 1st January 2001, restated	130,958	32,837	20,235	3,218	266,076	453,324
Shares issued upon conversion of bonds	31,324	-	-	-	-	31,324
Shares issued upon exercise of options	6,014	-	-	-	-	6,014
Shares issue expenses	(9)	-	-	-	-	(9)
Profits attributable to shareholders	-	-	-	-	78,623	78,623
Final dividends paid	-	-	-	-	(20,773)	(20,773)
Translation of PRC subsidiaries financial statements	-	-	-	176	-	176
<b>As at 30th June 2001</b>	<b>168,287</b>	<b>32,837</b>	<b>20,235</b>	<b>3,394</b>	<b>323,926</b>	<b>548,679</b>

### **13. Capital commitment**

As at 30th June 2001, the Group has capital commitment for acquisition of equipment and machinery and construction of buildings at HK\$26,975,000 (2000: HK\$59,426,000).

### **14. Post balance sheet events**

On 10th July 2001, the Company entered into a shares placing and subscription agreement to issue 105,200,000 new ordinary shares at HK\$2.45 each to several independent institutional investors.

## **INTERIM DIVIDEND**

The Board has resolved to declare an interim dividend of HK2 cents per share to the shareholders whose names appear on the register of members on 28th September 2001 for the six months ended 30th June 2001 and payable on or before 10th October 2001.

## **CLOSURE OF REGISTER OF MEMBERS**

The register of members of the Company will be closed on 27th September 2001 and 28th September 2001, during these two days no transfer of shares will be registered. To qualify for the above declared interim dividend, all transfers accompanied by the relevant share certificates, must be lodged with the Company's Share Registrars in Hong Kong, Central Registration Hong Kong Limited, Rooms 1712-1716, Hopewell Centre, 183 Queen's Road East, Hong Kong for registration not later than 4:00 p.m. on 26th September 2001.

## **MANAGEMENT DISCUSSION AND ANALYSIS**

### **Financial results**

For the six months ended 30th June 2001, the Group recorded a turnover of HK\$333,059,000, representing an increase of 38% compared to the HK\$242,131,000 recorded in the previous corresponding period. Sales of rare earth products and refractory products amounted to HK\$212,133,000 and HK\$120,926,000 and increased by 25% and 66%, respectively, comparing to the amounts for the six months ended 30th June 2000. The increment was mainly due to the expanded production capacity, which was completed in mid-2000. Although there was a decrease in the average gross profit margin by less than 2%, the net profit margin remained at 23% compared with the previous corresponding period. Profit attributable to shareholders was HK\$78,623,000, represents an increase of 38% over that of the previous period. Basic earnings per share reached HK11.46 cents.

### **Business review**

Rare earth products constitute an important production element for a number of different industries. They are extensively used in both traditional industries, such as steel metallurgy, construction glass and petroleum, and new industries, such as those from the high-tech sector. The global economic slow down and the sluggish performance of the information technology industry have impacted the rare earth market and certain products prices have fallen. However, the downward adjustment of the prices of the Group's value-added quality products were much lower than that

of the lower end products from other manufacturers. Moreover, supported by its leading market position and stable customer base, the Group's turnover still recorded a strong growth. The Group is confident of the profit growth this year as it has secured contracts for the whole year.

By the end of the review period, the Group inaugurated an expansion of its rare earth separating production line for ionic ore. The new production line has further enhanced the Group's annual production capacities to 6,500 tonnes (REO). With the installation of the most advanced controlling systems as well as the adoption of leading rare earth separating techniques, the new production line is the largest facility of its kind in the country. It can separate 15 rare earth elements from Lanthanum to Lutecium in a single process. Notably, the new production line employs the Two-Solvent Extraction technology in separation of heavy rare earth products, which further enhances the Group's production qualities and lowers production costs, thus enables the Group to outperform other industry players. The installation of an integrated gas generating system also improves the Group's calcinations process and supports environmental protection.

To further strengthen its research and development ("R&D") activities, the Group imported the most advanced instruments for product analysis such as ICP spectroanalyzer and Cilas particle size analyzer from France and the United States. The specialist's expertise of the R&D division is focused on enhancing the quality of existing products and developing new products including new materials for nano technology; seeking breakthroughs in the years to come. Extending its sales and marketing network, the Group places a strong emphasis on maintaining close relationship and contacts with customers and it is also actively seeking new business.

Fulfilling the Group's commitment to environmental protection, the Group has constructed facilities with an automated PH monitoring system. This expansion project for rare earth products has gained recognition from the environmental protection authority.

For refractory products, the Group's annual production capacity reached 50,000 tonnes after an expansion plan had completed in June 2000. Through intensive cooperation with a leading player in the global refractory materials industry, new products are being developed which are expected to contribute to a gradual increase in the export portion of the products from the current 10% to 50% over the next few years.

In the first half of 2001, about 69% of the Group's rare earth products were exported to the United States, Japan, Europe and other regions. The export ratio to Europe is achieving a steady and constant growth. Around 11% of refractory products were exported to overseas, with export ratios also growing steadily.

### **Liquidity and financial resources**

As at 30th June 2001, the Group had cash and bank balances of HK\$143 million and retained bank loan balances at HK\$40 million. Net assets of the Group increased to HK\$619,604,000 by 19% from HK\$520,853,000 as at 31st December 2000. Convertible bonds issued in last June

were fully converted by the end of the period. Total liabilities to total assets ratio was further decreased to 17% from 22%. By adopting prudent financial management measures, the Group is able to sustain a healthy financial position to support future business development.

## **Prospects**

Since its listing on The Stock Exchange of Hong Kong Limited in October 1999, the Group has achieved satisfactory operating results and stock performance. The Group will be included as a constituent stock in the Mainland Series of the Hang Seng Composite Index from 3rd October 2001, indicating the market recognition of the Group's outstanding achievement.

The PRC will soon join the World Trade Organization, which will further intensify globalization of the PRC economies, resulting in the opening up of the PRC market. This will also continue to boost the demand for rare earth materials and widen its applications. For refractory materials, production will steadily move from the developed countries to the PRC. The Group will seize these opportunities to expand its scope of rare earth materials application, particularly in the exploration and production of rare earth luminous materials. The Group will also increase the production of quality refractory products, expanding export markets, enlarging business scale and boosting market share.

### **1. Expansion of production facilities**

To expand production capacities for its refractory materials and to develop downstream value-added products for rare earth, the Group raised approximately HK\$254,500,000 through the placement of 105,200,000 new shares at HK\$2.45 each to professional and institutional investors in July 2001.

The expansion of production facilities of refractory materials has already commenced and it is expected to be completed in the first half of next year. Upon completion, the annual production capacity of refractory materials will reach 80,000 tonnes. At the same time, the Group's expansion of its rare earth metal production line has been scheduled to commence in the fourth quarter of the year.

### **2. Lowering production costs, enhancing management skills**

To enhance cost efficiency of its operations and stabilize the supply of raw materials, the Group will persistently formulate plans to stabilize the rare earth resources and the supply of raw materials of the refractory business. To consolidate its corporate strengths and further strengthen its foundation, the Group is placing every effort into enhancing its quality control and R&D capabilities, bringing in foreign techniques, appointing a Japanese refractory product expert as its chief engineer, and continuing to employ and train up young professionals.

### **3. Emphasis on production safety and environmental protection**

To meet the production safety regulations of the state, a special team was established by the Group to ensure the safety of all production processes. Fire prevention measures have been

introduced and training on safety issues is provided to staff members to improve their techniques and knowledge on production safety. The Group also makes sure that its production processes are environmental friendly through implementing various measures including using fuel that produces less pollutant and expanding its environmental protection facilities. The Group plans to apply for ISO14000 certification and expects to complete the certification by the end of the year.

## DIRECTORS' INTERESTS IN SHARES OR DEBENTURES

As at 30th June 2001, the interests of the directors and chief executives of the Company in the equity or debt securities of the Company and its subsidiaries and associated corporations as recorded in the register maintained by the Company pursuant to Section 29 of the Securities (Disclosure of Interests) Ordinance ("SDI Ordinance") were as follows:

### 1. The Company

Director	Nature of interests	Number of shares held
Qian Yuanying	Corporate interests ( <i>Note 1</i> )	415,000,000
Huang Chunhua	Personal interests	1,868,000

### 2. Subsidiaries

(a) *Xinwei Rare Earth Group (Hong Kong) Limited*

Director	Nature of interests	Number of non-voting deferred shares held
Jiang Quanlong	Personal interests	7,000,000
Qian Yuanying	Personal interests	3,000,000

(b) *Yixing Xinwei Leeshing Rare Earth Company Limited*

Director	Nature of interests	Equity interests
Jiang Quanlong	Corporate interests ( <i>Note 2</i> )	5%

*Notes:*

- These shares are held through YY Holdings Limited, the entire issued share capital of which is held by the trustee of the Jiang family trust, the discretionary object of which is a company wholly owned by Ms. Qian Yuanying and her children.
- The equity interest is held by Xinwei Group Limited, a PRC domestic enterprise 5% owned by Mr. Jiang Quanlong with remaining 95% owned by a brother of Ms. Qian Yuanying. Mr. Jiang is also the legal representative of the enterprise.



## **DIRECTORS' RIGHTS TO ACQUIRE SHARES OR DEBENTURES**

There was a Share Option Scheme which was approved by the shareholders of the Company, under which the directors may, at the discretion, invite any full time employee or executive director of the Company or its subsidiaries to take up options at HK\$1 each as a consideration to subscribe for shares in the Company.

As at 30th June 2001, no such options had been granted.

## **SUBSTANTIAL SHAREHOLDERS**

As at 30th June 2001, the register of substantial shareholders maintained under Section 16(1) of the SDI Ordinance shows that the Company has been notified of the following interests, being 10% or more of the Company's issued share capital.

<b>Shareholder</b>	<b>Number of shares held</b>
YY Holdings Limited	415,000,000

## **PURCHASE, SALE OR REDEMPTION OF THE COMPANY'S LISTED SECURITIES**

There has been no purchase, sale or redemption of any of the Company's listed securities by the Group during the six months ended 30th June 2001.

## **AUDIT COMMITTEE**

The Audit Committee has reviewed the accounting principles and practices adopted by the Group and discussed auditing, internal control and financial reporting matters, including the review of the interim financial statements which have not been audited.

## **CODE OF BEST PRACTICE**

None of the directors is aware of any information that would reasonably indicate that the Company is not, or was not for any part of the six months ended 30th June 2001, in compliance with the Code of Best Practice as set out in Appendix 14 of the Listing Rules.

By order of the Board  
**Jiang Quanlong**  
*Chairman*

Hong Kong, 10th September 2001