

## MANAGEMENT DISCUSSION AND ANALYSIS

### Financial Results

For the six months ended 30 June 2005, the Group recorded a turnover of HK\$375,505,000, representing an increase of approximately 12% compared with HK\$336,471,000 in the corresponding period of 2004. Contributing approximately 50% of the Group's total turnover, the sales of rare earth products (including fluorescent materials) amounted to HK\$187,116,000, an increase of around 18% compared with HK\$158,574,000 in the corresponding period last year. Sales of refractory materials (including high temperature ceramics) amounted to HK\$188,389,000, as compared with HK\$177,897,000 in the corresponding period last year. Gross profit margin slightly decreased from 26% to around 24%.

After that the Group's subsidiaries Wuxi Xinwei Fluorescent Materials Company Limited and Wuxi Xinwei High Temperature Ceramics Company Limited (formerly Wuxi Pan-Asia High Temperature Ceramics Company Limited) are required to pay a 50% reduced Enterprise Income Tax in the PRC since last year, full amount of Enterprise Income Tax commenced to be levied on Yixing Xinwei Leeshing Rare Earth Company Limited and Yixing Xinwei Leeshing Refractory Materials Company Limited this year. Thus, taxation for the period surged to HK\$16,984,000, representing an increase of approximately 90% as compared with HK\$8,981,000 in the corresponding period last year. Profit before taxation reached HK\$73,789,000, though it was higher than HK\$69,868,000 in the corresponding period last year, profit after taxation dropped around 7% to HK\$56,805,000. Net profit margin was approximately 15%. Earnings per share were HK5.69 cents.

## Business Review

### *Rare Earth Business*

In the first half of 2005, development varied for different elements in the rare earth segment. As compared with the same period last year, the price of praseodymium oxide, neodymium oxide and dysprosium oxide, which are applied in magnetic materials, and europium oxide, which is applied in fluorescent materials, grew at different percentages ranging from 5% to 25%, while the price of terbium oxide and yttrium oxide decreased by approximately 15%. During the period under review, while the sales volume of rare earth and related downstream products increased slightly to approximately 2,200 tonnes, sales amount grew 18% to HK\$187,116,000. However, the gross profit margin of rare earth products dropped to approximately 13%. The drop was due mainly to the persistently hefty raw material costs caused by tense supply. Amongst different materials, prices of auxiliary materials including oxalic acid, liquid soda and fuel increased over 10% as compared to the same period last year. Some suppliers in Baotou, Inner Mongolia suspended production and the resultant limited supply of rare earth ore in the Northern region also presented additional pressure. Besides, the cancellation of export tax rebate for rare earth products by the PRC government since 1 May 2005 increased export costs. Polishing materials business is still in its preliminary development stage. As for the fluorescent materials business, the tight power supply in the PRC and government policies aimed at accelerating the building of an energy-efficient nation have continued to support its steady growth.

In terms of market, the amount of overseas orders returned to normal in the first half of 2005. In the last corresponding period, certain overseas customers ordered in advance at the end of 2003 taking into consideration the reduction of export tax rebate for rare earth products in 2004. Boasting faster growth, the PRC market continued to be the dominant contributor of sales accounting for around 75% of total sales.

### *Refractory Materials Business*

Refractory materials business of the Group continued its stable growth and the domestic market was its major focus. Affected by the macro-economic control measures implemented by the PRC government, the growth of the property, metallurgy, construction material industries slowed down, and the demand for refractory materials also softened. In the first half of 2005, the Group sold approximately 33,800 tonnes of refractory materials, approximately 30% of which were high temperature ceramics, leveled the volume of the same period last year. Prices remained stable. The prices of major products such as fused magnesia-chrome bricks, zircon bricks, magnesia-alumina spinel bricks and AZS bricks, varied less than 5% compared with that in last corresponding period. During the period under review, sales reached HK\$188,389,000, representing approximately a 6% increase over the same period last year. The raw material and auxiliary material costs continued to increase, with the prices for fused magnesia clinker and chrome ore over 10% higher than that in the same period last year, and the price for zircon sand even surged over 30%. However, at the Group's efforts to strengthen internal management and cost control, the gross profit margin was maintained at above 30%.

### **Prospects**

Though the shadow of the revaluation in Renminbi suppressed the export growth, the Group targets to maintain stable business growth by flexibly adjusting the production strategies and passing the cost increment onto customers.

In the past few years, the Group obtained strong production capability through expansion of production facilities and technology investment. The Group always sees raw materials resources as vital to its business development in the long term, hence, it has been studying the possibility of investing in the magnesium ore in Northeast China, which is the raw material for refractory materials products, and the rare earth mines in Southern China. Regarding rare earth mines, the Group will continue to negotiate with the relevant authorities and hopefully an investment plan can be implemented in the near future to gain the advantage of resources control.

The Group will continue to strive to develop value-added rare earth products as well. Regarding the fluorescent materials business, illumination accounts for roughly 10% to 15% of the total electricity consumption in the PRC currently. The PRC government plans to promote the use of energy-saving lights in the advent of the 2008 Beijing Olympics. Thus the Group is full of optimism for the future of the fluorescent materials market. To facilitate the business development of the newly-established polishing materials production line, the Group will endeavour to enhance customer recognition and confidence in its products, shorten the market research and analysis cycle, gear up for large-scale production and ultimately maximize the production efficiency. For the refractory materials business, the Group will continue to develop high temperature ceramics and expand the production capacity of Sialon production line. The preliminary installation of highly densified zircon bricks and highly densified chrome bricks production line will be completed soon. Pending fine-tuning of all equipments and techniques, the installation of the entire set of production facilities is expected to complete in the second half of this year or at the beginning of next year, and will commence production thereafter to meet market demands.

### **Liquidity and Financial Resources**

As at 30 June 2005, the Group had cash and bank balances of approximately HK\$213,239,000 within which there was a deposit at about HK\$320,000 pledged as business guarantee. Over 95% of the balance was deposited in banks in the PRC denominated in Renminbi. There was no bank borrowings and no contingent liabilities. Balance of net current assets rose to HK\$688,680,000. Total liabilities to total assets ratio remained below 10%.

The Group was not exposed to material foreign exchange risk or interest rate risk. There was no charge on assets of the Group.

### **Staff and Remuneration**

As at 30 June 2005, the Group had a workforce of approximately 1,400 staff. Comprehensive remuneration and welfare packages are offered to them. During the period, approximately HK\$10,010,000 was incurred in staff costs including directors' emoluments.

### **INTERIM DIVIDEND**

The Board does not recommend the payment of an interim dividend for the six months ended 30 June 2005.