MANAGEMENT DISCUSSION AND ANALYSIS

GROUP RESULTS

For the year ended 31 December 2005, the Group's results of the core business in XHIT, which was under the UPC Group acquired last year, recorded growth both in turnover and profit. Its turnover scored HK$201.8 million (2004: HK$192.2 million) and the profit attributable to shareholders was HK$121.1 million (2004: HK$108.3 million), representing an increase of 5.0% and 11.8% respectively as compared to last year. The net result margin of XHIT increased to 60.0% as compared to 56.4% of last year.

	2005 (HK$'000)	% of turnover	2004 (HK$'000)	% of turnover
UPC Group				
Turnover	**201,802**	100.0	192,184	100.0
Gross profit	**154,341**	76.5	150,085	78.1
Net results	**121,093**	60.0	108,337	56.4
Non-UPC Group				
Net results	**(28,524)**	(14.1)	6,432	3.3
Group reported results	**92,569**	45.9	114,769	59.7

However, if we compared the reported profit attributable to shareholders of the Company, there was a decrease from HK$114.8 million to HK$92.6 million. The drop was mainly due to the fact that in 2004, the financial statements were prepared under the reverse acquisition accounting method in accordance with the Hong Kong Accounting Standards. Under the reverse takeover accounting, the 2004 profit reported did not include the operating results of certain companies of the Group. In addition, there was a gain on disposal of subsidiaries in 2004. Furthermore, when acquiring UPC Group last year, a convertible note of HK$681 million was issued as part of the consideration, which bears an interest rate of 1% per annum. However, in accounting for the interest on the convertible note for 2005, the Company could not apply the actual interest payment but had to accrue and charge to profit and loss by adopting effective interest method, which resulting an interest charge higher than the note rate of 1%, in compliance with the new HKFRSs. The effect to the net profit was HK$9.3 million in this regard. Accordingly, the Group's net profit was impacted yet the convertible note holder did not in effect receive any extra

MANAGEMENT DISCUSSION AND ANALYSIS

interest. If comparing on the same basis as last year, the profit in UPC Group would have been HK$121.1 million for the years 2005. The following are the key financial figures of the Group for the two years ended 31 December 2005:

	2005 (HK$'000)	2004 (HK$'000)	Increase/ (decrease)
Turnover	**201,802**	192,184	5.0%
Earnings before interest and tax ("EBIT")	**129,800**	136,666	(5.0)%
Profit for the year	**92,561**	114,769	(19.3)%
EBITDA	**155,965**	162,021	(3.7)%
Earnings per share (HK cents)	**3.86**	20.81	
Diluted earnings per share (HK cents)	**2.80**	19.09	
EBIT Margin	**64.3%**	71.1%	
Net profit margin	**45.9%**	59.7%	

The basic and diluted earnings per share ("EPS") for the year were 3.86 Hong Kong cents and 2.80 Hong Kong cents (2004: 20.81 Hong Kong cents and 19.09 Hong Kong cents respectively). The decreases of both basic and diluted EPS were mainly attributable to the significant increase in number of ordinary shares issued by the Company during the year. The weighted average numbers of shares for the year ended 31 December 2005 in calculating basic and diluted EPS were 2,397,534,247 and 3,870,273,973 (2004: 551,639,344 shares and 601,256,830 shares respectively).

BUSINESS REVIEW

The Group's core business remained the operations of the oil and petrochemical terminal located in Xiao Hu Island of Nasha, Panyu, Guangdong Province in the PRC. The operational results of XHIT were as follows:

Operational Statistics	**2005**	2004	Increase/ (decrease)
Total number of vessels visited	**3,078**	3,405	(9.6)%
Foreign vessels berthed for unloading cargoes	**309**	379	(18.5)%
Number of trucks served to pick up cargoes	**40,386**	21,377	88.9%
Number of drums filled	**44,519**	45,385	(1.9)%
Port jetty throughput (million metric ton)	**4.96**	4.66	6.4%
Tank farm throughput (million metric ton)	**5.70**	5.04	13.1%

MANAGEMENT DISCUSSION AND ANALYSIS

XHIT is a comprehensive terminal and storage complex in Nansha Economic & Technological Development Zone, Panyu, Guangdong Province, the PRC, specialized in oil and liquid petrochemical products which comprises of a wharf with 5 docking spaces of capacity ranging from 500 deadweight ton ("dwt") to 30,000 dwt. Apart from the wharf jetties, XHIT, after installing 4 more tanks during the year, currently has a total 86 tanks making the tank farm with a total storage capacity of 330,450 cubic metres. During the year, all of 86 storage tanks have been operating at close to full occupancy. Almost all the statistics in 2005 showed that the operations were busier than last year in terms of throughput of the port and the tank farm. Meanwhile, XHIT reported 309 and 379 foreign tankers berthed for unloading cargoes and total throughput of 4,960,000 metric tons and 4,660,000 metric tons in its terminal for the two years ended 31 December 2005. The decrease in number of foreign tankers berthed for unloading in 2005 was attributable to the rocketing of international oil price since last year. As international oil price stood high, refined oil importers reduced their volume of oils shipped into China as the margin between the import price and the domestic retail or wholesales price was very thin, not to mention that they had to face the negative margins at some of the time in 2005. The costs of holding cargoes were therefore relatively high. In this connection, fewer foreign tankers visited the Pearl River Delta, including XHIT during 2005. Nevertheless, the total throughputs for 2005 increased as the long-term lease entered into between XHIT and China Petroleum & Chemical Corporation Guangdong Branch ("Sinopec Guangdong") commenced operation during the year. Sinopec Guangdong utilized the tanks in XHIT for the distribution of oils in the Pearl River Delta region markets; thus the frequency in using our port and tanks by them was higher than that of other customers. Furthermore, there were four petrochemical storage tanks built during the year and became fully operational in the second half of the year, which contributed some of the increase in throughput of petrochemical products of the terminal as well.

Revenue Breakdown

The following is the breakdown of major revenue items and its related percentage of the XHIT for the two years ended 31 December 2005:

	2005		2004	
	(HK$'000)	**%**	(HK$'000)	%
Terminalling, storage services and transshipment services	**182,982**	**90.7**	168,525	87.7
Port income	**18,820**	**9.3**	23,632	12.3
Trading of oil petrochemical products	**—**	**—**	27	—

Segment results of XHIT

For the year ended 31 December 2005, turnover from the provision of transshipment and storage facilities segment increased from HK$168.5 million to HK$183.0 million, representing an increase of 8.6% whereas the segment profit for the same period increased from HK$129.0 million to HK$138.8 million, representing an increase

MANAGEMENT DISCUSSION AND ANALYSIS

of 7.6%. The increase in both turnover and segment profit was in line with the increase in throughput in 2005 and was attributable to the leasing of 4 new petrochemical products storage tanks built and completed in second half of 2005. The change in type of products stored in the tank farm as a result of the new tanks also accounted for the improvement in turnover and profit of the segment.

For the year ended 31 December 2005, turnover from port income dropped approximately 20.4% from HK$23.6 million to HK$18.8 million and the segment profit decreased from approximately HK$21.0 million to HK$15.5 million, representing an decrease of 26.1%. Port income mainly comprises the port charge for every metric ton cargoes discharged at XHIT. This port charge is provided for under the relevant laws and regulations of the PRC, and a subsidiary of the Group, Guangdong (Panyu) Petrochemical Storage & Transportation Ltd. ("GD (Panyu)") is authorized by the relevant government authorities to collect this fee on their behalf. Since GD (Panyu) is the owner and the operator of wharf terminal, GD (Panyu) is entitled to receive part of proceeds of port charge and recognizes them as port income. The rates of port charges applicable to foreign cargoes are normally higher than domestic cargoes. The decrease in turnover and profit for this segment was in line with the decrease in number of foreign tankers berthed in XHIT during the year.

Outlook

The Group continues its long-term business development strategy of being a midstream player in the energy sector, providing specialized integrated terminalling, storage and logistics services for oil and liquid petrochemical products in the PRC as well as identifying other oil-industry areas for growth. To this end, the Group plans to develop the Pearl River Delta project as outlined below as well as other projects both inside and outside China.

- ***Business Development in XHIT***

  It is the Group's strategy to maintain its competitiveness within the region. XHIT will continue to improve its capabilities with state-of-art equipment and professional management skills. Four petrochemical tanks with a total capacity of 4,700 cubic metres were commissioned in June this year and started to bring additional revenue to the Group. At the same time, the Group has also development plans for further expansion within the site area including improvement in the capacity of truck loading stations, an information system enhancement project, as well as further jetty upgrading. It is perceived that the supply of storage space in the region will increase in the coming years. XHIT will concentrate to improve its internal work process in order to reduce its operating costs, provide incremental value to customers without incurring extra costs, and eliminate unnecessary work steps. On the other hand, XHIT has initiated programs to maximize the utilization of the storage space for additional storage rental. Furthermore, XHIT will concentrate to develop international customers to keep, in our tank farm, their high value products which usually require special skills and experience to handle, thus the rental and the associated services are more profitable to the Group. We believe that with the advance equipment, skillful production knowledge, experienced terminal operation

MANAGEMENT DISCUSSION AND ANALYSIS

management, professional customer-oriented approach services, high safety standards in handling dangerous and hazardous products, XHIT has the abilities to derive new businesses and maximize the utilization of the terminal and storage capacity.

China is now a substantial net oil importer and became the second largest oil importer worldwide in 2004. With the strong economy of the Pearl River Delta and its position as an industrial base, demand for oil and petrochemical products is expected to continue to grow. The Company therefore believes XHIT will continue to command a key position in the provision of specialised integrated terminalling, storage and logistics services for oil and petrochemical products in the Pearl River Delta region.

- ***Dongguan Terminal Project (Previously known as Pearl River Delta project)***

On 21 October 2005, the Group received the notice from Dongguan Development and Reform Bureau confirming that the National Development and Reform Council of the PRC had officially granted an approval to the Group's project of developing a new oil, gas and liquid petrochemical storage facility, including jetty terminal with a capability to accommodate tankers with capacity up to 80,000 deadweight tons, in Dongguan Humen Port Shatian Harbour Area in the PRC. Since then, the pre-construction preparation works including land formation tests, site clean-up, harbour under-water landscape scanning, jetty terminal design and storage tank farm design have been completed. It is currently anticipated that the early phases of the new facility will become operational in second half of 2007. According to the current design, the storage tank farm may have a capacity of 910,000 cubic metres, and the terminal may have 12 jetties with docking capacities ranging from 500 dwt to 80,000 dwt. With the construction of the new facilities, the Group's storage capacity will increase by approximately 275% (from 330,450 cubic metres to 1,240,450 cubic metres) and annual docking capacity will increase by approximately 166% (from 7,210,000 metric tons to 19,210,000 metric tons per annum).

In establishing the business for this new operation, the Management will share the successful experience in XHIT, by all effort, to secure stable leasing orders for the storage tanks with the solid customer base established over the years. We are confident in this respect as the development of the Dongguan Terminal was originally aimed to capture the opportunity of the growing demand of storage facilities as the result of the expansion plan of adjacent refineries within the region. The Group's capital investment in the project is estimated to be in excess of RMB800 million. It is currently anticipated that the early phases of the new facility will become operational in second half of 2007. The Company believes that the Group's competitive strength in the Pearl River Delta region will be considerably enhanced once the facility becomes operational.

MANAGEMENT DISCUSSION AND ANALYSIS

FINANCIAL REVIEW

Capital structure, liquidity and gearing

The capital structure of the Group changed during the year. During the period, 1,000 million new ordinary shares were issued, as a result of the exercising of the right by the Convertible Note holder to convert HK$300 million note into ordinary shares. In this regard, the balance due under the Convertible Note reduced from HK$681 million at the beginning of the period to HK$339.6 million and an equity component of HK$41.9 million as at 31 December 2005, which was reclassified in compliance with the new Hong Kong Financial Reporting Standard ("HKFRS"). In addition, another 100 million new shares were issued during the year.

As at 31 December 2005, the Group had a cash balance of HK$354 million (2004: HK$497 million). Most of the funds were held in HK$, RMB and US$.

As at 31 December 2005, the Group had a current ratio of 1.78 (31 December 2004: 1.12). The improvement in current ratio was mainly due to the repayment of short-term bank borrowings, the reduction of trade payables and amount due to related companies during the year.

The Group's gearing ratio of as at 31 December 2005 was 1.11 (31 December 2004: 1.67) (defined as total liabilities to total assets). The decrease of the ratio was attributable to the fact that the debt associated with the Convertible Note was reduced, first by way of the conversion of HK$300 million into share capital. Secondly, HK$74.8 million of the Convertible Note was reclassified as an equity component in compliance with the new HKFRS. Thirdly, the bank loans of HK$160.2 million and amount due to related companies of HK$103.5 million were settled during the year. Furthermore, HK$97.4 million was received from the issuance of new shares.

Financial resources

The Group has fully settled the bank borrowings brought forward from last year and due for repayment during the year. In this regard, the credit facilities, which were available until March 2005, have not been extended by the Group, and the assets originally pledged for the facilities were released.

The current cash reserves and recurrent operating cash flow is sufficient for the daily requirements for current operations. However, the Group will consider to raise external financing for development of new businesses, if required. Due attention will be paid to the capital and debt markets as well as the latest developments of the Group in order to ensure the efficient use of financial resources.

MANAGEMENT DISCUSSION AND ANALYSIS

Finance cost

Despite the repayment of bank borrowings during the period, the Convertible Note of HK$681 million issued on 24 December 2004 started to accrue interest this year. According to the new HKFRS, interest was accrued and charged to profit and loss by effective interest method. The total finance cost increased by HK$10 million to HK$19 million.

Taxation

The Group had no assessable profit subject to Hong Kong Profits Tax for the year. On the other hand, this year is the second year that GD (Panyu), the PRC subsidiary of the Group, is subject to PRC Enterprise Income Tax at the concessional rate of 7.5% (normal tax rate is 15%). This relief will continue to be available to GD (Panyu)'s XHIT business conducted in the Nansha Economic Development Zone until 2009.

Exposure to fluctuation in exchanges rate and related hedge

The Group's cash and cash equivalents are held predominately in HK$, RMB and US$. Operating outgoings incurred by the Group's subsidiary in the PRC are mainly denominated in RMB, which usually receives revenue in RMB as well. The management is of the opinion that the Group's exposure to foreign exchange rate risks is not significant, and hedging by means of derivative instruments is considered unnecessary.

Charge on Group assets

As at 31 December 2005, bank deposits of approximately HK$600,000 were pledged against credit card facilities granted by a bank. Other than the above, none of the assets of the Group was pledged to creditors.