

Management Discussion and Analysis

(A) Summary

In the year of 2005, the Group produced approximately 10,007 kg of gold (including approximately 9,391 kg of gold bullion and approximately 616 kg of compound gold), representing an increase of approximately 772 kg or 8.4% as compared with the previous year. The turnover and profit before tax for the year ended 31 December 2005 was approximately RMB1,555,704,000 and approximately RMB226,793,000, representing an increase of approximately 27.2% and approximately 26.8% compared with the previous year. The profit attributable to the Company's shareholders was

approximately RMB154,584,000, representing an increase of approximately 28.8% compared with the previous year. The earnings per share was RMB0.31 (based on 500,000,000 shares). In the year of 2005, the Company has positive growth in both turnover and profit attributable to shareholders. The increase of profit was due to the continuous expansion of production scale, improvement of economic and technical indicators, effective control of production cost, strong market demand as well as the high product prices.

(B) Review and Prospect of Business Segment

Mining Segment

Turnover and production

Our mining business comprises the sales of gold concentrates and other derivative products, such as compound gold and lead concentrates. All gold concentrates are sold to the Group's smelting plant as intra-group sales, while other derivative products are sold to third party customers.

	2005			2004		
	Amount RMB'000	Sales volume kg	Unit price RMB per kg	Amount RMB'000	Sales volume kg	Unit price RMB per kg
Gold concentrates	136,810	1,484	92,190	71,288	897	79,474
Compound gold	82,637	708	116,719	107,972	997	108,297
Henan region	54,235	474	114,420	107,972	997	108,297
Xinjiang region	28,402	234	121,376	–	–	–
Lead concentrates	29,518	257	114,856	29,824	262	113,832
Net of sales taxes	(60)			(79)		
Others	–			2,853		
	248,905			211,858		

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Turnover of the total mining segment of the Group for 2005 was approximately RMB248,905,000, representing an approximate 17.5% increase from approximately RMB211,858,000 for 2004. The production of compound gold decreased by approximately 422 kg to approximately 616 kg while production of gold concentrates increased by approximately 484 kg to approximately 1,443 kg. Since July 2005, there has been a change in technology of the processing facilities of our Henan's gold mines. We decreased compound gold production and switched to production of gold concentrates. The said change in technology was aimed to increase the gold content of our gold concentrates and boosting internal sales of gold concentrates to our smelting plant. Our Henan's gold mines have increased the volume of gold concentrates sold to the Group's smelting plant by approximately 65.4%, from approximately 897 kg in 2004 to approximately 1,484 kg in 2005. Apart from gold concentrates and compound gold, the Group's mining segment also produced lead concentrates. Lead concentrates are another type of gold concentrates which contain lead and are sold to third party customers. Production of lead concentrates has increased by approximately 21 kg to approximately 257 kg.

The Group is prospecting for the increase of production capacity of gold through the gold mines under construction including Hongxin Gold Mine and Kaqia Gold Mine, which will be commenced in 2006, together with the expansion of production volume in both Xinjiang Duolanasayi and Tuokuzibayi Gold Mines.

Segment results

The Group's total mining segment result for 2005 was approximately RMB70,906,000, representing an approximate increase of 56.2% from approximately RMB45,398,000 in 2004. Such increase was principally attributable to, apart from turnover growth, an approximate decrease of 9.8% in expenses paid to the construction teams of our operating mines. Furthermore, with the rise of gold prices, the gold concentrates and compound gold produced by our mines had an average increase of approximately 16.0% and 7.8% in unit price respectively. The newly acquired Habahe Huatai Gold Limited Liability Company ("Habahe Huatai") had also made profit contribution to the Group, which has improved the mining segment results. The segment result to segment turnover ratio of the Group's mining segment for 2005 was approximately 28.5%, a slight rise from approximately 21.4% for 2004.

With our continuous focused exploration and acquisitions of gold mines, especially in the Xiaoqinling region, our gold reserves are increasing. The Company's main objective for the year 2006 is to continue to explore the in-depth deposits of Qiangma Gold Mine and Yinxin Gold Mine in the Xiaoqinling region and to continue to engage in mining and gold production process in the Henan Nanyang Xingyuan, Jiangxi Mingxin, Xinjiang Duolanasayi, Tuokuzibayi and Kaqia Gold Mines, and accordingly, increasing the Company's gold reserves.

Capital expenditures

	2004	2005	2006	2007
	(Actual)	(Actual)	(Estimate)	(Estimate)
	RMB'000	RMB'000	RMB'000	RMB'000
Capital expenditures	77,084	81,553	259,304	265,330

Our principal capital expenditures relate to the provisions of construction of gold mines, purchase of mining rights and acquisition of mining corporations. The estimated capital expenditure for the years of 2006 and 2007 was obtained principally from the proceeds from the global offering of H shares in January 2006, proceeds from internally generated funds and bank loans.

Smelting segment**Turnover and production**

The Group's total turnover in the smelting segment turnover for 2005 was approximately RMB1,450,846,000, representing an increase of approximately 32.7% from approximately RMB1,093,698,000 for 2004. Such increase was principally attributable to the increase in both production capacity and the sales of gold bullion as a result of an approximate 7.8% and 14.8% increase in selling price and sales volume of gold bullion respectively. Also, the unit selling price, sales volume and total sales amount of copper products had increased by approximately 48.0%, 37.7% and 103.8% respectively.

In 2005, the Group has upgraded its roasting system of gold concentrates and has added a baking roaster with production capacity of approximately 100 tonnes per day, and thereby increasing the processing capacity to approximately 700 tonnes per day from approximately 600 tonnes per day in 2004. This resulted in the increase of our production capacity by approximately 16.7%. The Group's gold concentrates processing volume increased from approximately 201,705 tonnes in 2004 to approximately 236,058 tonnes in 2005. Production of gold bullion had been increased by approximately 1,194 kg to approximately 9,391 kg; production of silver had been increased by approximately 2,396 kg to approximately 33,331 kg; production of copper products had been increased by approximately 3,873 tonnes to approximately 9,994 tonnes; production of sulphuric acid had been increased by approximately 17,403 tonnes to approximately 151,212 tonnes. Apart from the increasing production quantities, our smelting plant has maintained a high recovery rate. The gold recovery rate increased by approximately 0.4% to approximately 96.5%, the silver recovery rate increased by approximately 2.5% to approximately 78.4% and the copper recovery rate increased by approximately 1.1% to approximately 93.2%.

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Segment results

Our total smelting segment results for 2005 was approximately RMB261,755,000, representing an approximate 22.8% increase from approximately RMB213,179,000 for 2004. The segment results to segment turnover ratio of our smelting business for 2005 was approximately 18.0%, down from approximately 19.5% for 2004. Such decrease was principally attributable to a faster growth in raw material costs as compared to selling prices of gold and

other by-products. In 2005 the total gold concentrate purchase cost was increased by 10.1% from approximately RMB90,410 per kg in 2004 to approximately RMB99,580 per kg in 2005, however the average selling price of gold bullion only increased by approximately 7.8%.

The Group is prospecting an increase in production capacity and recovery rates; also securing the supply of gold concentrates for the smelting segment.

Capital expenditures

	2004 (Actual) RMB'000	2005 (Actual) RMB'000	2006 (Estimate) RMB'000	2007 (Estimate) RMB'000
Capital expenditures	33,208	29,520	15,900	44,100

Our principal capital expenditures relate to the provisions of construction work, purchase of equipment and materials with regard to its development and expansion projects. The above estimated capital expenditure for the year ending 2006 and 2007 was obtained principally from the proceeds of the global offering of H Shares, proceeds from internal generated funds and bank loans.

(C) Financial Review

1. Combined Operating Results

Turnover

The following table sets out the Group's sales breakdown by products:

	2005			2004		
	Amount RMB'000	Sales volume kg/tonne	Unit price RMB per kg/tonne	Amount RMB'000	Sales volume kg/tonne	Unit price RMB per kg/tonne
Gold bullion	1,092,341	9,287 kg	117,620	882,866	8,092 kg	109,104
Compound gold	82,637	708 kg	116,719	107,972	997 kg	108,297
Henan region	54,235	474 kg	114,420	107,972	997 kg	108,297
Xinjiang region	28,402	234 kg	121,376	-	-	-
Silver	58,296	32,750 kg	1,780	53,009	32,863 kg	1,613
Copper products	258,859	7,746 tonne	33,418	127,047	5,626 tonne	22,582
Sulphuric acid	37,581	145,827 tonne	258	25,367	137,915 tonne	184
Lead concentrates	29,518	257 kg	114,856	29,824	262 kg	113,832
Turnover before sales tax	1,559,232			1,226,085		
Less: Sales tax	(3,528)			(2,656)		
	<u>1,555,704</u>			<u>1,223,429</u>		

The Group's turnover for the year ended 2005 was approximately RMB1,555,704,000, representing an approximate 27.2% increase compared with the previous year. Such increase was principally attributable to the increase of approximately 23.7% in the sales of gold bullion, as a result of the increase in our average selling price and volume of gold bullion sold of approximately 7.8% and 14.8% respectively during the corresponding period. In 2005, the Group has upgraded its roasting system of gold concentrates and added a baking roaster with production capacity of approximately 100 tonnes per day which increase the processing capacity

to approximately 700 tonnes per day in 2005, as compared to approximately 600 tonnes per day in 2004. Since July 2005, the processing technique of the processing facilities of Qiangma Gold Mine and Yinxin Gold Mine has been updated and a substantial part of our compound gold production in these two mines has been switched to gold concentrate production to increase the gold content of our gold concentrates and to increase the internal sales of gold concentrates to our smelting plant so that gold bullion production capacity can be enhanced. This is also the major reason behind the substantial decrease of

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compound gold production in mines of Henan region. In 2005, the Group had successfully acquired Habahe Huatai. Compound gold is a major product of Habahe Huatai, hence the selling of compound gold is a new addition to the Xinjiang mines.

The increase in turnover during the year was also due to the increase in the sale of copper product by approximately 103.8%, that is, from approximately RMB127,047,000 for 2004 to approximately RMB258,859,000 for 2005, of which the average price and sales volume of copper products increased by 48.0% and 37.7% respectively compared to that of 2004.

Cost of sales

The Group's cost of sales for 2005 was approximately RMB1,235,479,000 representing an approximate 26.7% increase from approximately RMB975,691,000 for 2004. Such increase was principally attributable to the increase of 26.6% in the average costs of direct materials, especially gold concentrates, to RMB1,009,501,000 as a result of the increase in production capacity, the growth of purchase volume and the increase in gold price. Owing to the rise in gold price, the unit purchase price of gold concentrates increased by approximately 10.1%, that is, from approximately RMB90,410 per kg in 2004 to RMB99,580 per kg in 2005.

Gross profit and gross profit margin

The Group's gross profit and gross profit margin for 2005 were approximately RMB320,225,000 and approximately 20.6% respectively, representing an increase of approximately 29.3% and 0.4% respectively as compared to that of 2004.

Other revenue

The Group's other revenue for 2005 was approximately RMB11,777,000, representing an approximate 4.8% decrease as compared with the previous year. Such change was principally attributable to government grant of RMB1,800,000 for exploration and smelting activities. In addition, there was an increase in dividend income from RMB900,000 for the year 2004 to RMB2,100,000 for the year 2005. In 2004, there was a waiver of accounts payable of RMB2,621,000 but nil in 2005.

Other net loss

The Group's other net loss for 2005 was approximately RMB1,148,000, representing an increase of 45.9% compared with the previous year. Such increase was principally attributable to the loss associated with the disposal of vehicles, machinery and equipment which amounted to approximately RMB1,008,000.

Selling and distribution expenses

The Group's selling and distribution expenses for 2005 was approximately RMB11,668,000, representing an increase of approximately 78.1% compared with the previous year. Such increase was principally attributable to the additional cost of transportation for the increased quantity of gold concentrates and by-

products from smelting process, and the rise of refinery cost. Transportation expenses for 2004 was approximately RMB5,756,000, representing an increase of approximately 53.3% to approximately RMB8,826,000 in 2005. The refinery cost for the gold bullion manufacturing procedure was approximately RMB1,515,000 in 2005, representing a substantial increase from approximately RMB127,000 in 2004. Such increase was principally attributable to the commencement of gold trading in the Shanghai Gold Exchange in December 2004.

Administrative expenses and other operating expenses

The Group's administrative expenses and other operating expenses for 2005 was approximately RMB71,299,000, representing an approximate 22.1% increase from approximately RMB58,416,000 for 2004. The increase was principally attributable to business development and the increase of other operating expenses which include the administrative expenses incurred in the additions of subsidiaries such as Habahe Huatai and Xinjiang Baoxin Mining Company Ltd., leading to an increase of approximately RMB8,427,000 in staff costs.

Finance costs

The Group's finance costs for 2005 was approximately RMB23,085,000, representing an approximate 48.9% increase from approximately RMB15,503,000 for 2004. The increase was principally attributable to the bank and other borrowings which was increased by

approximately RMB110,670,000 to RMB405,420,000 for the year ended 31 December 2005 while the People's Bank of China increased the benchmark interest rate from 5.31% in 2004 to 5.58% in 2005.

Income tax

The statutory income tax rate of the PRC is 33%, the Group was subject to an effective income tax rate (being total amount of income tax divided by the amount of profit before taxation) of approximately 31.8% for 2005, representing a decrease of approximately 1.4% from the effective income tax rate of 33.2% for 2004. The decrease was principally attributable to the approximately RMB2,135,000 tax credit granted by the local tax authority for purchasing domestically produced machineries and equipment and the increase of RMB1,063,000 tax benefits arising from the increase in non-taxable revenue.

Profit attributable to equity holders of the Company

The Group's profit attributable to our equity holders for the 2005 was approximately RMB154,584,000, representing an approximate 28.8% increase from approximately RMB120,060,000 for 2004. The net profit margin for 2005 was approximately 9.9%, representing an increase of approximately 0.1% from approximately 9.8% in 2004. The Company's basic earnings per share was RMB0.31 (based on 500,000,000 shares), a recommendation for the payment of a final dividend of RMB0.08 per share (based on 770,249,091 shares).

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2. Liquidity and capital resources

The Group's primary sources of working capital and long-term funding needs have been cash flows from operation and borrowings. The Group's primary use of funds has been capital expenditures, operating activities and repayment of borrowings.

Net cash inflow/(outflow) from:

	2005	2004
	RMB'000	RMB'000
Operating activities	63,379	61,643
Investing activities	(126,600)	(109,295)
Financing activities	104,576	36,286
Net cash inflow/(outflow)	41,355	(11,366)

Cash flows and working capital

The Group's cash and cash equivalents increased by approximately RMB41,355,000, that is, from approximately RMB76,506,000 at 31 December 2004 to approximately RMB117,861,000 at 31 December 2005. The increase in the cash and cash equivalents was primarily due to the increase in investing activities expenses offset by the cash inflow from operating and financing activities.

Net cash flows from operating activities

The Group's principal source of liquidity is cash generated from operating activities. Net cash inflow from operating activities increased by approximately 2.8%, that is, from approximately RMB61,643,000 in 2004 to approximately RMB63,379,000 in 2005. This was mainly due to an approximate 26.8% increase in profit before tax as a result of increased sales

price and volume of our products. However, net cash flows from operating activities increased only slightly from the same period. This was mainly due to an approximate 55.2% increase in inventories as a result of increased operating capital in order to cope with our business growth and expansion of production capacity.

Net cash flows from investing activities

The Group's net cash used in investing activities was primarily affected by purchase of property, plant and equipment and construction in progress. Net cash spent in investing activities increased by approximately 15.8%, that is, from approximately RMB109,295,000 in 2004 to approximately RMB126,600,000 in 2005. This was mainly due to an increase in additional payments of approximately RMB16,473,000 and approximately RMB10,188,000 arising from the acquisition of a subsidiary and the purchase of intangible assets in 2005 respectively.

Net cash flows from financing activities

The Group's net cash flows from financing activities was primarily affected by bank loans. Net cash flow from financing activities increased by approximately 188.2%, that is, from approximately RMB36,286,000 for the year ended 31 December 2004 to approximately RMB104,576,000 for the same period in 2005. This was mainly due to an increase of approximately RMB359,750,000 in the repayment of bank loans in 2005, partially offset by the increase of approximately RMB400,420,000 from the proceeds of bank and other loans obtained during the same period.

3. Borrowings

As at 31 December 2005, the Group had a total of outstanding bank loans and other borrowings of approximately RMB405,420,000, of which approximately RMB292,150,000 was repayable within one year, approximately RMB110,000,000 was repayable after one year but not exceeding two years while the remaining RMB3,270,000 was repayable after five years. The gearing ratio as at 31 December 2005 was 38.4% which was based on total borrowing divided by total assets value.

4. Security

As at 31 December 2005, our bank loans of approximately RMB88,600,000 in aggregate were secured by buildings with an aggregate net book value of approximately RMB40,188,000, machinery equipment with an aggregate net book value of approximately RMB70,897,000, inventories of approximately RMB100,000,000 and trade receivables of approximately RMB12,000,000.

5. Material investment

On 18 April 2005, the Group established Jiangxi Mingxin Mining Company Limited which is a 80% subsidiary.

On 19 May 2005, upon the completion of an expansion project on the Group's smelting capacity, a smelting branch of the Group with a gold concentrate processing capacity of 100 tonnes per day commenced operation. Since then, the Group's gold concentrates processing capacity has reached 700 tonnes per day in aggregate.

6. Material acquisition and disposal

On 29 June 2005, the Group completed the acquisition of 83.3% of Habahe Huatai.

On 15 July 2005, the Group completed the acquisition of 80% of Tongbai Xingyuan Mining Company Limited.

7. Market risks

The Group are exposed to various types of market risks, including fluctuations in gold and other commodities prices, changes in interest rates and foreign exchange rates.

Gold price and other commodities price risk

The Group's turnover and profit are affected by fluctuations in the gold prices and other commodities price as all of our turnover and profit are generated within the PRC. We do not enter into commodity derivative instruments or futures to hedge any potential price fluctuations of gold and other commodities or for trading purposes. Therefore, fluctuations in the prices of gold and other commodities may have a significant effect on the Group's turnover and profit.

Interest rate

The Group is exposed to risks resulting from fluctuations in interest rates on our debt. The Group undertakes debt obligations for support general corporate purposes, including capital expenditure and working capital needs. Our bank loans bear interest rates that are subject to adjustment by our lenders in accordance with changes to the relevant People's Bank

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of China (“PBOC”) regulations. If the PBOC increases interest rates, our finance cost will be increased. In addition, to the extent that we may need to raise debt financing in the future, upward fluctuations in interest rates will increase the cost of new debt.

Foreign exchange

The Group’s transactions are all denominated in Renminbi. Therefore, fluctuations in exchange rates may affect the international and domestic gold price, which may impact our results of operation. The exchange rates of Renminbi have been relatively stable during the past few years. The Renminbi is not a freely convertible currency. However, the PBOC has raised the level of Renminbi trades against the U.S. dollars by 2.1% on 21 July 2005 and the currency would fluctuate against a basket of currencies. In light of the above situation, the PRC government may take further actions and measures on free trade of Renminbi. Fluctuations in exchange rates may adversely affect the value, when such are being converted to Hong Kong dollars, of our net assets, earnings and any dividends we declare.

8. Contractual obligations

As at 31 December 2005, capital commitments, representing the construction costs not provided for in the financial statements, were approximately RMB282,642,000, representing a decrease of approximately RMB99,198,000 from approximately RMB381,840,000 as of 31 December 2004.

As at 31 December 2005, our total future minimum lease payments under non-cancellable operating leases amounted to approximately RMB2,130,000, of which approximately RMB246,000 was payable within one year, approximately RMB920,000 payable after one year but within five years, and approximately RMB964,000 payable after five years.

9. Contingent liabilities

As at 31 December 2005, the Group had no material contingent liabilities.

10. Employees

In 2005, average number of employees of the Group was 2,391.