

MANAGEMENT DISCUSSION AND ANALYSIS

Financial Results

For the six months ended 30 June 2006, the Group recorded a turnover of HK\$470,703,000, representing an increase of approximately 25% compared with HK\$375,505,000 in the corresponding period of 2005. Contributing approximately 49% of the Group's total turnover, the sales of rare earth products (including fluorescent materials) amounted to HK\$231,712,000, an increase of around 24% compared with HK\$187,116,000 in the corresponding period of last year. Sales of refractory materials (including high temperature ceramics and magnesium grains) was HK\$238,991,000, increased by around 27% from HK\$188,389,000 in the corresponding period of last year. Gross profit margin increased from 24% to around 30%.

The Group's profit before taxation reached HK\$124,684,000, representing an increase of approximately 69% as compared with HK\$73,789,000 in the corresponding period of last year. The Group's subsidiaries Wuxi Xinwei Fluorescent Materials Company Limited and Wuxi Xinwei High Temperature Ceramics Company Limited continued to enjoy 50% reduction of Enterprise Income Tax in the PRC. The Group's profit for the period, after deducting taxation of HK\$28,725,000, was HK\$95,959,000. Net profit margin was approximately 20%. Earnings per share were HK8.80 cents.

In December 2005, the Group acquired the entire equity interest in Haicheng City Suhai Magnesium Ore Co., Ltd. ("Suhai Magnesium") in Liaoning Province, the PRC. This acquisition has not only enabled the Group to secure stable supply of raw materials for its refractory materials business, but has also presented the Group with a new source of profit. The turnover and net profit of Suhai Magnesium, HK\$24,210,000 and HK\$7,669,000 respectively, were reflected in the first half 2006 consolidated financial statements.

Business Review

Rare Earth Business

In the first half of 2006, the rare earth industry in the PRC continued on the up trend which started in 2005. The strong demand for neodymium, praseodymium, terbium and dysprosium used in the magnetic material industry drove their prices up continuously. For instance, the prices of neodymium oxide and praseodymium oxide increased by 20% to 30% between January and June 2006, while the prices of terbium oxide and dysprosium oxide surged even more by 40% to 50%. However, prices of certain products dropped. For example, prompted by the shrinking color television market (the major consumer of yttrium products), some rare earth manufacturers dumped yttrium products at very low prices. As a result, the sale price of the Group's yttrium oxide during the reporting period dropped around 5% when compared with the same period of last year. Given the substantial increase in prices of rare earth products, despite that the Group sold less of rare earth products to around 2,000 tonnes during the reporting period against the corresponding period of last year, its sales revenue increased by 24% to HK\$231,712,000.

Regarding production cost, because the PRC Government has tightened control on rare earth resources supply and stepped up regulation and standardization of mining of mineral resources, the prices of rare earth resources have been on the rise persistently. For instance, the average price of rare earth oxide resources had increased by around 50% between December 2005 and June 2006. However, having applied its strengths to prepare for the rise in prices of rare earth resources, the Group has been able to effectively mitigate the impact of climbing material prices on its production costs. During the period under review, the gross profit margin of its rare earth business increased to around 20%.

By market, the PRC market accounted for around 75% of the Group's rare earth sales, about the same as in the corresponding period of last year.

Refractory Materials Business

The Group's refractory materials business maintained stable growth during the period, with total sales reaching HK\$238,991,000, around 27% more than that in the same period of last year. As the prices of major products such as fused magnesia-chrome bricks, magnesia-alumina spinel bricks, alumina-graphite bricks and AZS bricks varied no more than 5% when compared with the last corresponding period, the gross profit margin of general refractory materials products was at similar level as in the last corresponding period. The higher margin high temperature ceramics business achieved better performance during the period under review. Although there was no significant changes in the average sales price of the products, thanks to increase in sales volume which brought down average cost, the gross profit margin of the high temperature ceramics business increased by approximately 30%. The magnesium grains business acquired by the Group in late 2005 also recorded a high gross profit margin of 50%. As a result, the gross profit margin of the refractory materials segment grew to approximately 38%. In terms of sales volume, the total sales volume of general refractory materials and high temperature ceramics reached a total of approximately 40,000 tonnes, 18% more than that in the same period of last year. One third of the total sales volume was attributable to high temperature ceramics. The Group also sold about 10,500 tonnes of fused magnesium grains during the period under review.

The PRC is still the Group's principal market for refractory materials. Taking into account the magnesium grains business, which sales primarily attributable to the local market, the PRC market brought in around 80% of the total sales of the Group's refractory materials business. The remaining mainly came from export to Japan.

Prospects

In February 2006, the Group forged strategic alliance with General Electric Company, one of the largest integrated business corporations in the world. Pursuant to the alliance, General Electric will substantially increase order for various rare earth products from the Group. General Electric will also provide technical support to the Group's value-added rare earth business to help it extend the applications and production scale of rare earth products.

Besides, the Group will continue to explore and develop more downstream products for rare earth, such as catalysts for automobile exhaust gas treatment, hopefully to add new products to its portfolio after fluorescent materials and polishing materials for launching in the market. The Group will also continue to look for opportunities to invest in rare earth mines so as to speed up creation of a vertical industrial chain.

As for the refractory materials business, in addition to strengthening investment in and development of its existing businesses, the Group will capitalize on the opportunities arising from the acquisition of Suhai Magnesium in late 2005 to tap the abundant magnesium resources in Liaoning Province. Its aim is to build the high purity magnesium grains business on its solid foundation of fused magnesium grains business. The project will commence in the second half of 2006 with total investment estimated at around HK\$400 million to HK\$500 million. The project construction will take two years to complete. Upon completion, it will enable the Group to secure supply of raw materials for its refractory materials business and thus effectively control costs. It will also be an additional income stream for the Group.

Placing of Shares

The Company conducted a fund raising activity in the first half of 2006. In March to April, the Company placed 197,390,000 new shares at HK\$1.38 per share. Upon the completion of the placing, the total number of issued shares of the Company increased to 1,184,343,059 shares and the public float increased to over 49%. The net proceeds from the placing amounted to approximately HK\$264,120,000. The raised fund will be used as general working capital.

Liquidity and Financial Resources

As at 30 June 2006, the Group had cash and bank balance of approximately HK\$473,247,000 within which there was deposit at about HK\$108,416,000 pledged for business guarantee and banking facilities utilized. With pledged deposit, the Group raised a short term bank loan at RMB95,000,000 in May 2006 and which will be repayable before the end of the year. There was no contingent liabilities. Balance of net current assets rose to HK\$1,007,540,000. Total liabilities to total assets ratio rose to around 12%.

The Group was not exposed to material foreign exchange risk or interest rate risk. Apart from the deposit pledged as stated above, there was no charge on assets of the Group.

Staff and Remuneration

As at 30 June 2006, the Group had a workforce of approximately 1,600 staff. Comprehensive remuneration and welfare packages are offered to them. During the period, HK\$11,901,000 was incurred in staff costs including directors' emoluments.

INTERIM DIVIDEND

The Board has resolved to declare an interim dividend for the six months ended 30 June 2006 of HK 1 cent per share to the shareholders whose names appear on the register of members on 6 October 2006. The dividend will be payable on or before 27 October 2006.

CLOSURE OF REGISTER OF MEMBERS

The register of members of the Company will be closed on 5 October 2006 and 6 October 2006, during these two days no transfer of shares will be registered. To qualify for the above declared interim dividend, all transfer documents accompanied by the relevant share certificates must be lodged with the Company's Share Registrar in Hong Kong, Computershare Hong Kong Investor Services Limited, Rooms 1712-1716, Hopewell Centre, 183 Queen's Road East, Hong Kong for registration not later than 4:00 p.m. on 4 October 2006.

SHARE OPTION SCHEME

On 4 June 2004, the shareholders of the Company approved the termination of the share option scheme adopted on 14 October 1999 (the "Old Scheme") and the adoption of a new scheme for the purpose of coping with the amendments introduced to Chapter 17 of the Listing Rules. Upon the termination of the Old Scheme, no further options would be offered pursuant to the Old Scheme but the Old Scheme would in all other respects remain in force to the extent necessary to give effect to the exercise of the outstanding options granted under it prior to its termination, and such outstanding options will continue to be valid and exercisable in accordance with the provisions of the Old Scheme.

Details of options which have been granted under the Old Scheme and remain outstanding as at 30 June 2006 were as follows:

Grantee	Date of grant	Exercise price	Number of options	
			Held at 1 January 2006	Held at 30 June 2006
<i>Employees</i>				
In aggregate	23 January 2003	HK\$1.10	1,500,000	1,500,000

The options granted are exercisable between 27 January 2003 to 26 January 2013, provided that 50% of the options granted shall not be exercised prior to 27 January 2004. No option was granted, exercised, cancelled or lapsed during the period.

DIRECTORS' INTERESTS AND SHORT POSITIONS

As at 30 June 2006, the interests and short positions of the directors and chief executive of the Company and their associates in the shares, underlying shares and debentures of the Company and its associated corporations as recorded in the register kept by the Company pursuant to Section 352 of the Securities and Futures Ordinance ("SFO") or as otherwise notified to the Company and The Stock Exchange of Hong Kong Limited pursuant to the Model Code for Securities Transactions by Directors of Listed Issuers were as follows:

1. Interests in shares of the Company

Director	Nature of interest/ Capacity	Number of shares	% to the issued share capital of the Company
Jiang Quanlong	Interest of spouse/ Interest of controlled corporation	594,400,000 (<i>Note</i>)	50.19%
Qian Yuanying	Founder of a trust	594,400,000 (<i>Note</i>)	50.19%
Huang Chunhua	Beneficial owner	2,268,000	0.19%

Note: These shares are held through YY Holdings Limited, the entire issued share capital of which is held by YYT Limited, the trustee of YY Trust, the discretionary object of which is a company wholly owned by Ms Qian Yuanying, the spouse of Mr Jiang Quanlong, and her children. Ms Qian Yuanying is a founder of YY Trust within the meaning under Part XV of the SFO. Mr Jiang Quanlong is the sole director of YY Holdings Limited.

2. Interests in shares, underlying shares or equity interests in associated corporations

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

Director	Nature of interest/ Capacity	Number and class of issued shares	% in the class of shares in the issued share capital of the Company
Jiang Quanlong	Beneficial owner	7,000,000 non-voting deferred shares	70%
Qian Yuanying	Beneficial owner	3,000,000 non-voting deferred shares	30%

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

Director	Nature of interest/Capacity	% equity interests
Jiang Quanlong	Interest of controlled corporation	5%

Note: The equity interest is held by Yixing Xinwei Group Co. Ltd., a PRC domestic enterprise 90% owned by Mr Jiang Quanlong, with the remaining 10% owned by his son. Mr Jiang is also the legal representative of the enterprise.

(c) *YY Holdings Limited*

Director	Nature of interest/ Capacity	Number of issued shares	% in the class of shares in the issued share capital of the Company
Qian Yuanying	Founder of a trust	1 ordinary share	100%
Qian Yuanying	Founder of a trust	25,000 preference shares	100%
Jiang Quanlong	Interest of controlled corporation	1 ordinary share	100%
Jiang Quanlong	Interest of controlled corporation	25,000 preference shares	100%

Note: The entire issued share capital of YY Holdings Limited is held by YYT Limited, the trustee of YY Trust, the discretionary object of which is a company wholly owned by Ms Qian Yuanying, the spouse of Mr Jiang Quanlong, and her children. Ms Qian Yuanying is a founder of YY Trust within the meaning under Part XV of the SFO. Mr Jiang Quanlong is the sole director of YYT Limited.

Save as disclosed above, as at 30 June 2006, none of the directors or chief executive of the Company and their associates had or was deemed to have any interest or short position in the shares, underlying shares and debentures of the Company and its associated corporations as recorded in the register kept under Section 352 of the SFO.