You should read the whole document before you decide to invest in our H Shares, and you should not rely solely on key or summarized information. The financial information in this section has been extracted without material adjustment from "Appendix IA—Accountants' Report of our Company" and "Appendix IB—Accountants' Report of Tianye Chemical".

OVERVIEW

We are one of the largest and most efficient nitrogenous fertilizer producers in terms of production volume and energy consumption, respectively, in China, based on statistics published by the CNFA. China is the largest mineral fertilizer consuming country in the world according to the IFA. The core of our operations is the production and sale of urea, the most commonly used nitrogenous fertilizer in China. As one of the major subsidiaries of CNOOC, the third largest petroleum company in China, and a sister company of CNOOC Limited, one of the world's largest oil and gas exploration and production companies in terms of reserves, we are well-positioned to further enhance our fertilizer operations through organic expansion. We also seek to benefit from potential industry consolidation in China, which we expect will provide us with the opportunity to accelerate our production capacity and market expansion through selective acquisitions. In line with such strategy, we acquired Tianye Chemical, a large-scale producer of urea and methanol based in Huhhot, Inner Mongolia.

As of the Latest Practicable Date and as a result of the Acquisition, our total designed production capacity of urea was 1,840,000 tonnes per annum from three production facilities: (i) Fudao Phase I, a large-scale urea production facility in China, with a designed annual production capacity of 520,000 tonnes; (ii) Fudao Phase II, currently the largest single urea production facility in China in terms of designed production capacity, with a designed annual production capacity of 800,000 tonnes; and (iii) Tianye Plant, another large-scale urea production facility, with a designed annual production capacity of 520,000 tonnes. Fudao Phase I and Fudao Phase II are located in Hainan, whereas Tianye Plant is located in Inner Mongolia. Each of our principal production plants is equipped with facilities that utilize advanced technologies. Our extensive sales network, through our own sales force and through wholesalers, extends across 20 provinces in China.

While continuing to focus on fertilizer operations, we are also expanding into the production of high value-added synthetic chemical products. In addition to urea, we produce methanol as our other main product. Through CNOOC Jiantao, we have constructed a large-scale methanol plant and are constructing ancillary transportation facilities within our production complex in Hainan. Trial production commenced in September 2006. Upon the commencement of mass production, expected in January 2007, CNOOC Jiantao Methanol Plant will add 600,000 tonnes of designed annual production capacity to our existing 200,000 tonnes of designed annual methanol production capacity at Tianye Plant.

All of our principal production facilities, including CNOOC Jiantao Methanol Plant, use natural gas as the principal raw material for their production of urea and methanol. Natural gas is considered to be more environmentally friendly compared to other natural resources, such as coal and oil, as combustion of natural gas releases fewer harmful pollutants into the atmosphere. Our production complex in Hainan is conveniently and strategically located in an area close to abundant sources of natural gas supplied from offshore gasfields operated by CNOOC Limited. We have entered into long-term natural gas sale and purchase agreements on a take-or-pay basis to provide our production complex in Hainan with stable and reliable supplies of natural gas, our key raw material.

In 2005, on an actual basis, we had a total revenue of RMB2,371.0 million and a net profit of RMB943.8 million. In the three months ended 31 March 2006, on an actual basis including Tianye Chemical, we had a total revenue of RMB697.7 million and a net profit of RMB746.9 million (including a one-off gain of RMB577.6 million generated from the Acquisition). In the year ended 31 December 2005, Tianye Chemical had a total revenue of RMB745.4 million and a net profit of RMB173.0 million.

CNOOC, the dominant developer of offshore oil and gas resources in China, has the exclusive right under current PRC regulations to enter into production sharing contracts with international oil and gas companies for crude oil and gas exploration and production offshore China. CNOOC has now expanded to midstream and downstream petroleum businesses. We are one of the major downstream businesses of CNOOC, concentrating on natural gas-based fertilizers and chemicals. We benefit from and leverage our position as the sole subsidiary of CNOOC engaged in the fertilizer business in terms of new resources discovery, synergy, business culture and governance, as well as brand recognition and corporate image.

THE ACQUISITION OF TIANYE CHEMICAL

We acquired equity interests in Tianye Chemical from its then shareholders, namely China Haohua Chemical Industry (Group) Corporation (中國昊華化工(集團)公司), State-owned Assets Supervision and Administration Commission of Inner Mongolia Autonomous Region People's Government, Guotou Assets Management Corporation (國投資產管理公司) and China Cinda Assets Management Corporation (中國信達資產管理公司). As a result of the Acquisition, we own a 90% equity interest in Tianye Chemical while the State-owned Assets Supervision and Administration Commission of Inner Mongolia Autonomous Region People's Government owns the remaining portion.

Tianye Chemical is a large-scale nitrogenous fertilizer and chemical producer in China and its production facilities, or Tianye Plant, are equipped with advanced technologies. As of the Latest Practicable Date, Tianye Chemical's designed annual production capacity for urea was 520,000 tonnes. Substantially all of the ammonia produced at Tianye Chemical is used for its urea production. Tianye Chemical started its business utilizing residual oil as its principal raw material. In October 2005, Tianye Chemical converted its facilities from oil-based to gas-based production, increasing its cost efficiency substantially. Tianye Chemical also owns a new methanol facility with a designed production capacity of 200,000 tonnes of methanol per annum as of 31 December 2005. This methanol facility was completed on 11 December 2005 and commenced mass production on 1 April 2006. Substantially all of Tianye Chemical's revenues in the Track Record Period were from sales of traditional prill urea products.

Tianye Chemical's 1.7 km^2 production complex is based in the Inner Mongolia Autonomous Region where the PRC Government encourages industrial developments and where abundant natural gas and coal resources are located. It is situated near major gasfields in northwestern China and also close to major coal production regions in China, including Shanxi and Shaanxi Provinces and Inner Mongolia.

By means of the Acquisition, we have been able to significantly increase our production scale, broaden our customer base and immediately capture new markets in northern and northeastern China at a cost substantially below that of building a new plant of equivalent scale. We also anticipate that this

expansion of our geographical coverage from the southern to the northern regions of China will reinforce our position as a leader in China's nitrogenous fertilizer market.

The operating results of Tianye Chemical for the Track Record Period were not consolidated with our results on a historical basis but were consolidated with ours from 19 January 2006 when we obtained control of Tianye Chemical. As a result, our operating results for the three months ended 31 March 2006, which consolidated Tianye Chemical's operating results, are not comparable to the same period in the previous year.

COMPETITIVE STRENGTHS

We believe that the following principal competitive strengths contribute to our historical success and future prospects:

Well-positioned to benefit from the growth of the fertilizer market in China

According to the IFA, China was the largest fertilizer consuming country in the world in 2003, with approximately 26.5% of world consumption, and was estimated by the IFA in November 2005 to remain the largest consuming country in the world in both 2004 and 2005. More than 90% of our and Tianye Chemical's respective revenues in the Track Record Period were generated from sales of urea products. As in other areas around the world, urea is the most widely consumed mineral fertilizer among all mineral fertilizers in China. According to the CNFA, apparent consumption of urea in China rose from 13.7 million tonnes nutrient to 18.5 million tonnes nutrient between 2000 and 2005, representing a CAGR of 6.19%.

We expect that the steady growth of China's population will lead to increasing demand for agricultural products. We believe that China's urbanization and industrialization will result in a continued decline in available arable farm land, thus making it essential for China to raise its agricultural products yield to ensure adequate food supply. We also believe that, at the same time, economic reform in China will lead to a growth in consumer demand for cash crops such as vegetables and fruits, which generally require the application of higher volumes of fertilizers than traditional farm crops. As a result of these factors, we anticipate that the demand for and the usage of mineral fertilizers in China will increase. As one of the largest and most efficient nitrogenous fertilizer producers in China in terms of production volume and energy consumption, respectively, we are well-positioned to benefit from the growth of the Chinese fertilizer market.

Convenient and cost efficient location of our main production complex

Our production complex in Hainan is conveniently and strategically situated in close proximity to its major natural gas supplies, enabling us to save on the transportation costs of natural gas and reduce transportation risks for our production facilities in Hainan. Moreover, the majority of the urea products from our Hainan production facilities are shipped from our Port of Basuo, the second largest deepwater seaport in Hainan in terms of freight throughput, situated only five kilometers away from our Hainan production facilities. Port of Basuo is readily accessible to many large ports in mainland China and to more than 20 countries and regions. The coastal location of our production complex within a short distance from major roadways and the national railway system allows our customers to transport our urea products by roadways and recently constructed railway systems in addition to shipping by seagoing vessels.

Sales in the fertilizer industry are subject to seasonality, with sales in both the northern and southern hemispheres much higher in their respective spring and summer seasons than in the autumn and winter seasons. Our Hainan production facilities are conveniently located at the southern end of China, enabling us to distribute our fertilizer products to Australia and New Zealand in the southern hemisphere and Southeast Asia during seasons when sales in the northern hemisphere are low. Our ability to market our fertilizer products all year round and during different planting seasons helps to mitigate the impact of seasonality on our operating results.

Secure and stable supplies of environmentally friendly and cost competitive raw materials

The three principal raw materials used to produce urea are coal, oil and natural gas. Natural gas is the principal raw material for our production of urea and methanol. We believe that natural gas is becoming an increasingly important source of energy for industrial, commercial and residential uses in China due primarily to its thermal efficiency and environmentally friendly nature. Based on statistics published by the CNFA, of the three principal raw materials, natural gas-based production tends to be more efficient in terms of energy consumption and competitive in terms of unit production cost than production processes which use other raw materials, such as coal and oil, for the production of urea, particularly during periods of high oil prices such as the past two years. Although we expect that the increasing demand in China for natural gas both as a production raw material and as a fuel is likely to intensify in the future, thereby potentially resulting in price increases, we are able to limit the effect of the fluctuation in natural gas prices through our long-term natural gas sale and purchase agreements for supplies to our production facilities in Hainan.

We are able to source stable and reliable natural gas supplies from offshore gasfields operated by CNOOC Limited for production at Fudao Phase I, Fudao Phase II and CNOOC Jiantao Methanol Plant pursuant to 20-year natural gas sale and purchase agreements on a take-or-pay basis, which expire in 2016, 2023 and 2026, respectively. Under the terms of our natural gas sale and purchase agreements, the price at which natural gas is supplied to our production facilities in Hainan is subject to upward or downward adjustments on a quarterly or monthly basis with the frequency of such adjustments and specific adjustment formulae varying between agreements, and by reference to the average price of four major types of crude oil in the international markets during the preceding quarter or month as compared to the historical moving average of the four crude oil prices in the preceding years, subject to caps and floors as agreed upon in the agreements. Such pricing mechanism can help us to minimize the impact of natural gas price volatility in the global market on our natural gas costs, and we believe that the terms of our natural gas sale and purchase agreements will enable us to compete favorably against our competitors. We also seek to benefit from any new gas discoveries by CNOOC Limited in future expansions of our production capacity and consequent requirements for additional oil and gas supplies.

Advanced technology producing high quality products

We utilize advanced technology at each of our production complexes in Hainan and Inner Mongolia. The technology we utilize reduces energy consumption rates and ensures high product quality. Fudao Phase I, built in 1996, utilizes ICI-AMV ammonia synthesis technology and Italy's SNAMPROGETTI ammonia stripping technology. Fudao Phase II, built in 2003, utilizes KBR ammonia synthesis technology from the United States and urea production technology from Stamicarbon S.A. For both Fudao Phase I and Fudao Phase II, we imported the granulating facilities and the underlying

fluid-bed granulating technology from Norsk Hydro, a Norwegian company. Our Tianye Plant utilizes Kellogg technology for its ammonia synthesis and SNAMPROGETTI technology for urea synthesis. We also utilize our anti-agglomerate chemical technology for our production at Fudao Phase I and Fudao Phase II, where we use our formaldehyde to produce a solution which we blend into our granular urea products to improve their durability so that they are less likely to crumble and to prevent clumping of the granules. This anti-agglomerate chemical technology also enables our granular urea products to dissolve at slower rates than traditional urea prills and thus offers more cost-effective application. We have installed advanced methanol technologies and facilities from Germany's Lurgi Group for the new CNOOC Jiantao Methanol Plant. Tianye Chemical also procured its integrated ammonia and methanol production technology as well as its equipment from one of the leading contractors for chemical equipment in China.

The premium quality of our urea products is reflected in their higher nitrogen content and lower moisture and biuret content than the national standard. "Fudao," the brand name under which we market our granular urea products from our production complex in Hainan, has established itself as a premium name in China and is generally recognized in the markets where we sell our products, particularly in the coastal provinces of southern China. Our "Fudao" products have received a number of awards from various PRC Government agencies and trade associations in recognition of their high product quality. Those awards include "Hainan's Premium and New Product" granted by the Hainan Provincial Government in 1997, "National Key New Products" by the Ministry of Science and Technology in 1998, "Recommended Product" by China Agriculture Association in 1999, "Certificate For Exemption From Product Quality Examination" by the National Quality and Technology Supervision Bureau in 2001, "Hainan's Well-Known Product" and "Hainan's Award For Quality Control" by the Hainan Provincial Government in 2002 and 2003, respectively. In addition, we market urea products from our Tianye Plant under the brand "Tianye" in Inner Mongolia and northern and northeastern China. We believe our high quality urea products marketed under our well-established and widely recognized trademarks have also enabled us to sell our products at higher prices.

An experienced and capable management team committed to leading us in accordance with international best practice and corporate governance standards

Our management team has an average industry experience of over 10 years in the areas of production, engineering, financial and business management. We believe our management team possesses the leadership, vision and in-depth industry knowledge required to anticipate and take advantage of market opportunities, to formulate sound business strategies, and to execute the strategies in an effective manner to maximize the benefit to our shareholders. In addition, through its extensive experience with CNOOC, our senior management is widely exposed to, and committed to leading our business in accordance with, international management philosophy, best practice and corporate governance standards. We believe that our senior management has been able to achieve cost-efficient organic and acquisitive growth of our business as well as effective integration of management and operations.

We also believe that CNOOC's prudent corporate management system, business philosophy and corporate culture contributed to the success of our historical growth. Leveraging on our operating and management experience at Fudao Phase I, we expanded our production through the construction and successful commencement of mass production at Fudao Phase II in 2004. The construction was completed two months prior to the scheduled completion date, resulting in a significant budget saving, and received the Lu Ban Award for Excellent Projects (建築工程魯班獎) in recognition of the

construction quality of Fudao Phase II in 2005. The award is the highest level of its kind in China for engineering and quality excellence and is granted annually by the PRC Ministry of Construction and Association of Construction Industry of China, with its recipients selected nationwide under stringent criteria.

One of the few companies well-positioned to benefit from industry consolidation in China

China's fertilizer industry is at present highly fragmented. We believe that, because economies of scale are an important source of efficiency and competitiveness in the fertilizer industry, the industry will experience more consolidation in the long term. As one of the largest and most efficient nitrogenous fertilizer producers in China in terms of production volume and energy consumption, respectively, and with strong management and technical expertise, we believe we are well-positioned to benefit from potential consolidation within the fertilizer industry. In pursuing our two-pronged growth strategy of organic and acquisitive growth, we intend to seek a balanced approach between the two with the objectives of creating value for our shareholders, improving the financial performance of our Company and strengthening our market presence. Our acquisition of Tianye Chemical was in line with our on-going growth strategy. The Acquisition enabled us to further reinforce our leading position in the nitrogenous fertilizer industry in China and to expand our geographic reach in the northern and northeastern regions of China while broadening our product offerings. Moreover, China has committed to gradually relax its current restrictions over the domestic fertilizer market, including import quotas and foreign investment restrictions, as part of its WTO obligations, allowing a more market-driven business environment to develop. As a large-scale and efficient nitrogenous fertilizer producer in China, we believe we will be well-positioned to meet the demand of such a market-driven business environment.

BUSINESS STRATEGIES

Our long-term goal is to leverage our leading position in the nitrogenous fertilizer market to seek a leading position in China's mineral fertilizer market, while at the same time strengthening our position in China's chemical industry. Our ultimate objective is to create value for our shareholders. To fulfill our mission and achieve these objectives, we will focus on the following strategic initiatives:

Continue to solidify our market leadership position in China's nitrogenous fertilizer industry and develop other differentiated fertilizer products

We are one of the largest producers of urea products in China in terms of production volume. We began our fertilizer business with our operation of Fudao Phase I, a facility with a designed production capacity of 520,000 tonnes of urea per annum. Our total designed annual production capacity of urea grew to 1,320,000 tonnes after commencement of operations of Fudao Phase II in 2004. We plan to further expand our overall production capacity and operations through our two-pronged strategy of organic and acquisitive growth, with the aim of benefiting from synergies and from economies of scale.

While leveraging our position as the sole subsidiary of CNOOC engaged in the fertilizer business, we will continue to expand our scale of operations organically and to evaluate potential strategic acquisition opportunities with the aim of further strengthening our market presence. Pursuant to this strategy, we acquired Tianye Chemical, increasing our total designed annual production capacity of urea by 520,000 tonnes. In response to China's agricultural development and trend towards

more balanced application of fertilizers, we have also entered into a research agreement with a leading agricultural science institute in the PRC and intend to establish strategic relationships with global fertilizer producers to develop, produce and market new, higher margin fertilizer products such as compound NPK fertilizers. In addition, we plan to provide value-added services such as soil testing and fertilizer prescription. As a market leader in China's nitrogenous fertilizer market, we believe that we have the resources and execution capability to actively explore and exploit value-enhancing opportunities, as well as to expand our range of fertilizer products.

Maintain our cost competitiveness

We aim to improve our cost competitiveness by attaining higher production yield, optimizing maintenance schedules, enhancing our technology, improving our budget management and procuring steady supplies of raw materials. To further improve our operational efficiency, we are in the process of implementing ERP for our operations in Hainan. The ERP system will manage, control and track all aspects of our operations in Hainan, including inventory control, raw material and energy supplies, operation and maintenance of our production equipment, quality control of our products and delivery of our products through our internal transportation and delivery facilities. We expect to implement such system in Hainan in 2006 and thereafter in Inner Mongolia, and that such system will provide us with up-to-date information and enable us to optimize our allocation of resources in terms of financial planning and operational management. We believe that we will be able to manage our business and operations more efficiently with such a system in place.

Because we believe that securing access to natural resources at a competitive cost is essential to enhancing our competitiveness, we intend in our future expansion projects, whether organic or through acquisitions, to focus on locations with ready and cost competitive supplies of raw materials with a view to gaining direct access to secure and stable supplies of natural resources.

Expand our operations in China's chemical market through capacity expansion and product extension

While focusing on our fertilizer operations, we plan to continue to seek opportunities to develop high-margin synthetic chemical products through the construction of new production complexes, acquisitions, or investments in chemical producers in China. As of the Latest Practicable Date, we had not identified any specific targets for acquisition or investment. The acquisition of Tianye Chemical has enabled us to add methanol production facilities with a designed annual production capacity of 200,000 tonnes to our asset portfolio. Through CNOOC Jiantao, we have constructed a large-scale methanol plant within our production complex in Hainan. Trial production commenced in September 2006. Upon the commencement of mass production, expected in January 2007, the new methanol plant will increase our total designed annual production capacity of methanol to 800,000 tonnes. We also plan to construct a further methanol production facility with a designed annual production capacity of 1.13 million tonnes of methanol, subject to obtaining relevant approvals and permits. The investment in the construction project will be funded from cash and cash equivalents generated from operating activities and external borrowings, and not from the proceeds of the Global Offering. In addition, we plan to construct a production facility for the manufacture of polyoxymethylene at Tianye Plant. The construction is expected to commence in November 2006 and is expected to be completed by November 2008. Upon its completion, the new production facility is expected to have a designed annual production capacity of 60,000 tonnes of polyoxymethylene. In February 2006, we commenced the operation of a new CO_2 plant in Hainan to produce and supply

food-class carbon dioxide using gaseous emissions from Fudao Phase II as the raw material. As of the Latest Practicable Date, the plant was in trial operation.

Attract, retain and develop highly-talented personnel

We believe that our employees have been an important element of our success. We intend to further enhance our existing clear and decisive management procedures through: (i) a highly transparent performance assessment system aiming to identify and recognize our most outstanding personnel; (ii) appropriate delegation of responsibility to management and clear criteria for granting duties and responsibilities and measuring achievements; (iii) performance-based employee compensation and incentives; and (iv) implementing a training system that enables members of our management and our employees to enhance their professional skills through on-the-job training as well as external training.

Consistently create value for shareholders

We believe that an important element of our success has been the commitment of our dedicated management team to deliver shareholder value. Our management team, through its experience with CNOOC, has an average of over ten years' experience in the fertilizer and petrochemical industries. We share not only CNOOC's corporate image but also its corporate governance, and we are determined to follow its well-established management system consistently. To continue to maximize shareholder value, we, under the leadership of our experienced management team, intend to:

- maintain our current principal operations;
- selectively expand our operations where we believe we can achieve high financial return;
- align our management's interests with those of our shareholders;
- maintain prudent financial management that may enable us to protect our business from any market volatility; and
- maintain an advantageous capital structure.

SEGMENTATION AND REVENUES

The following tables break down the sources of revenue of our Company and Tianye Chemical for the periods indicated:

	Year ended 31 December						Three months ended 31 March			
	2003[2]		2004[2]		2005[2]		2005[2]		2006[3]	
Our Company	RMB (million)	%	RMB (million)	%	RMB (million)	%	RMB (million)	%	RMB (million)	%
			(audited)				(unaudited)		(audited)	
Fertilizer operations[1]	709.8	96.2	1,962.2	96.8	2,259.9	95.3	486.8	96.3	662.4	94.9
Other[4]	28.4	3.8	65.1	3.2	111.1	4.7	18.8	3.7	35.3	5.1
Total	738.2	100.0	2,027.3	100.0	2,371.0	100.0	505.6	100.0	697.7	100.0

Tianye Chemical	Year ended 31 December 2003 RMB (million)	2003 %	2004 RMB (million) (audited)	2004 %	2005 RMB (million)	2005 %
Fertilizer operations	591.3	99.4	840.1	99.5	740.5	99.3
Other	3.8	0.6	4.3	0.5	4.9	0.7
Total	595.1	100.0	844.4	100.0	745.4	100.0

(1) Figures include sales of granular urea and compound fertilizer sold to external customers and in 2006 traditional prill urea.

(2) Figures do not include revenues generated by Tianye Chemical.

(3) Figures include revenues generated by Tianye Chemical from 19 January 2006 onwards.

(4) Figures mainly include revenues from transportation services and port operations we provided to external customers.

During the Track Record Period, we generated sales revenue mainly from external sales of fertilizer products, principally consisting of granular urea and compound fertilizer products prior to the Acquisition. After the Acquisition, we also generated revenues from sales of traditional prill urea produced at Tianye Plant. In addition, we generated service revenue from the provision of logistics services, including port operations and transportation services to external customers. Although methanol operations currently comprise one of our business segments, we did not generate any revenue from the production and sale of methanol during the Track Record Period because CNOOC Jiantao Methanol Plant was not in operation during the Track Record Period and because Tianye Chemical did not commence mass production of methanol until April 2006.

For the years ended 31 December 2003, 2004 and 2005, Tianye Chemical generated sales revenue mainly from its external sales of traditional prill urea products. Although Tianye Chemical also operated in methanol segment, it did not generate any revenue from the production and sales of methanol because its new methanol plant did not commence mass production until April 2006.

PRODUCTS

Principal Products

Urea (H_2N-CO-NH_2)

We are one of the largest producers of urea products, the most commonly-used nitrogenous fertilizer, in China. As of the Latest Practicable Date, we had a designed annual capacity to produce 1,840,000 tonnes of urea products, among which 1,320,000 tonnes of capacity is located in our Hainan production facilities and 520,000 tonnes of capacity is located in our Tianye Plant. The following table sets forth the amount of urea we and Tianye Chemical produced and sold during the Track Record Period, in the respective period:

	Year ended 31 December			Three months ended 31 March	
	2003[1]	2004[1]	2005[1]	2005[1]	2006[2]
	Volume (tonnes)	Volume (tonnes)	Volume (tonnes)	Volume (tonnes)	Volume (tonnes)
Our production of urea	602,373[3]	1,412,939	1,361,013	294,774	433,358[4]
Our sales of urea	572,276[3]	1,379,906	1,364,607	318,000	455,572[4]
Tianye Chemical's production of urea	570,228	583,650	491,322	152,209	159,664
Tianye Chemical's sales of urea	543,015	664,509	489,239	150,262	177,383

(1) Representing the information during the Track Record Period before the Acquisition.

(2) Representing the information including the production and sales of Tianye Chemical in the period, although Tianye Chemical's sales were only consolidated into our accounts from 19 January 2006.

(3) Fudao Phase II did not commence mass production and start generating revenue until 1 January 2004, while it commenced trial production in 2003. The figures do not include the production and sales volumes we generated from the operation at Fudao Phase II prior to 1 January 2004.

(4) In the first three months of 2006, Tianye Chemical produced 159,664 tonnes and sold 177,383 tonnes of urea, which were also included in the information of urea production and sales of our Company in the first three months of 2006, although Tianye Chemical's sales were only consolidated into our accounts from 19 January 2006.

The urea products from our Hainan production facilities are produced and marketed in granular form, while those from Tianye Plant are produced and marketed in traditional prill form. Both granular urea and traditional prill products are used in China, and end users tend to purchase either granular urea or traditional prill products depending on their specific needs.

In addition to their use as a fertilizer product, our urea products are also used for industrial applications, including raw materials for urea-formaldehyde resins and melamine production and feed stock for hydrolysis to form ammonia.

Granular Urea

As a fertilizer product, urea serves as both a direct-application fertilizer and as an ingredient in compound fertilizers and fertilizer blends. We utilize our anti-agglomerate chemical technology for our production at Fudao Phase I and Fudao Phase II to improve the durability of our granular urea products so that they are less likely to crumble and to prevent clumping of the granules. Our granular urea products dissolve at slower rates than traditional urea prills and thus offer more cost-effective application. We believe that we are able to charge a premium for our granular urea over traditional prill products due to the following properties:

- a reduced injurious biuret level and moisture concentration;

- an increased endurance towards crushing and impact and decreased dust content and possibility of caking; and
- a decrease in urea loss attributable to the large granule size and slow-release property, thus substantially reducing the nitrogen loss due to the nitration effect and significantly increasing the nitrogen absorption.

Our granular urea products, traded under the name of "Fudao", have received awards from various PRC Government agencies and trade associations in recognition of their product quality, including "Hainan's Premium and New Product" by the Hainan Provincial Government in 1997, "National Key New Products" by the Ministry of Science and Technology in 1998, "Recommended Product" by China Agriculture Association in 1999, "Certificate For Exemption From Product Quality Examination" by the National Quality and Technology Supervision Bureau in 2001, "Hainan's Well-Known Product" and "Hainan's Award For Quality Control" by the Hainan Provincial Government in 2002 and 2003, respectively.

Traditional prill urea

Tianye Chemical's principal product is traditional prill urea, which is widely used, especially for agricultural products with short harvest cycles. After the Acquisition, we continue producing traditional prill urea products at Tianye Plant, which requires different granulating technologies from the granular urea products produced at Hainan. We generally sell traditional prill urea products at a lower unit price than granular urea products.

Compound Fertilizers

We produce compound NPK fertilizers containing a blend of nitrogen, phosphorus and potassium (NPK) nutrients in our production facilities in Hainan. As a fertilizer product, NPK fertilizers are efficient and sustaining, promoting balanced application of nutrient components in the soil and enhancing soil fertility. As of the Latest Practicable Date, we had a designed annual capacity to produce 50,000 tonnes of NPK fertilizers. We source the urea for our blends from our own urea production facilities in Hainan, while phosphorus and potassium are sourced from third parties. We produced and sold sixteen different blends of compound fertilizers in our regular business operations during the Track Record Period. In addition, we have engineers who specialize in the blending of primary nutrients to provide tailor-made blends according to our customers' specifications and needs. Our NPK fertilizer products are sold under our reputable trade name, "Fudao". We sell our products mainly in Hainan Province to a wide range of customers, including rubber producers and banana farmers.

Methanol (CH_3OH)

Methanol, also known as methyl alcohol or wood alcohol, is a clear bio-degradable chemical compound that is made from renewable biomass sources and non-renewable fossil fuels containing carbon and hydrogen such as natural gas. Methanol is the chemical building block used to produce a number of other chemicals, including formaldehyde and other chemical derivatives such as dimethyl ether, an aerosol spray propellant, MTBE, an oxygenate used in cleaner-burning gasoline, and acetic acid. See "Industry Overview".

As of the Latest Practicable Date, our Tianye Plant had a designed annual production capacity of 200,000 tonnes of methanol. Tianye Chemical started mass production and sale of methanol in April 2006. Prior to 2006, the principal business activities of Tianye Chemical's methanol operations included the construction and upgrading of its joint urea and methanol facilities.

Through CNOOC Jiantao, we constructed a methanol production plant within our production complex in Hainan. Upon the commencement of mass production, expected in January 2007, the new CNOOC Jiantao Methanol Plant will increase our total designed annual production capacity of methanol to 800,000 tonnes. See "—Principal production facilities—Existing facilities. Once CNOOC Jiantao commences mass production, it is intended that no less than 400,000 tonnes of methanol per annum will be supplied to Hong Kong Kingboard, our joint-venture partner and a 40% shareholder of CNOOC Jiantao, for its own usage and consumption. See "Connected Transactions—Kingboard Product Sales and Services Agreement".

Carbon Dioxide (CO_2)

We constructed a new CO_2 plant in Hainan which uses gaseous emissions from Fudao Phase II to produce and supply food-class carbon dioxide. The plant commenced operations in February 2006 and, as of the Latest Practicable Date, was in trial operation. See "—Principal production facilities—Existing facilities".

Carbon dioxide is a colorless gas used in the production of carbonated beverages. Liquid and solid carbon dioxide are important refrigerants, especially in the food industry where they are employed during the transportation and storage of ice cream and other frozen foods. Solid carbon dioxide is called "dry ice" and is used for small shipments where refrigeration equipment is not practical. We also intend to sell our food-class carbon dioxide to producers of carbonated soft drinks and soda water.

Products under Development

Polyoxymethylene -(-O-CH_2-)$_n$-

Polyoxymethylene, or POM, also known as polytrioxane or polyformaldehyde, is formed from the polymerization of formaldehyde and is an important polyacetal resin. It is an engineering plastic used to make gears, bushings and other mechanical parts. POM is a thermoplastic with good physical and processing properties. It has the following characteristics: low relative density, good shock resistance and endurance, excellent wear resistance and corrosion proof properties, self lubricating and good electrical conductivity. Products and parts made from POM are widely used in the automobile, electronics, industrial machinery and agriculture industries. See "—Principal production facilities—Future facilities".

PRINCIPAL PRODUCTION FACILITIES

We have three technologically advanced ammonia and urea production facilities, two methanol facilities and other ancillary production facilities in Hainan and Inner Mongolia. Two ammonia and urea production facilities are located in a complex occupying approximately 1.3 km^2 of land in Dongfang City, Hainan Province. One ammonia and urea production facility and one methanol facility are located in Huhhot, Inner Mongolia, under the operation of Tianye Chemical.

Existing Facilities

Urea Production Facilities

Our two integrated ammonia and urea production plants, Fudao Phase I and Fudao Phase II, are located side-by-side in Hainan. In addition, we own a third ammonia and urea production facility in Huhhot, Inner Mongolia, under Tianye Chemical's operation. Each integrated ammonia and urea production plant includes an ammonia synthesis facility, a urea production facility and a granulating facility. The ammonia production capacities at Fudao Phase I, Fudao Phase II and Tianye Plant can fully support our urea production at Fudao Phase I, Fudao Phase II and Tianye Plant, respectively. With our current technology at these facilities, every tonne of ammonia can produce approximately 1.75 tonnes of urea, which is higher than the average industry standard in China.

Fudao Phase I was built in 1996. We imported the ammonia synthesis facility from two Japanese general contractors for chemical production facilities and equipment manufacturers following a tender process pursuant to which they were selected based on their qualifications, price and advanced technology. Chiyoda Corporation, an Independent Third Party headquartered in Japan, is an integrated engineering contractor providing services in the field of engineering, procurement, construction for gas processing, refining and other industrial plant projects. Nissho Iwai Corporation, also an Independent Third Party, is a global company that engages in a diverse range of business activities, including the fields of machinery, aerospace, energy and mineral resources, foods and consumer products, construction and urban development. The ammonia synthesis facility, utilizing ICI-AMV ammonia synthesis technology, is designed to produce 300,000 tonnes of ammonia per annum. We also imported the ammonia stripping facility, which utilizes SNAMPROGETTI technology, from Italy. The urea production facility has a designed production capacity of 520,000 tonnes of urea per annum (on a 300-day basis).

Fudao Phase II was built in 2003. We imported the ammonia synthesis facility as well as the underlying ammonia synthesis technology from KBR, a U.S. chemical production facilities general contractor and technology provider. The ammonia synthesis facility is designed to produce 450,000 tonnes of ammonia per annum. We also imported the urea production facility, the patented CO_2 stripping technology and pool condenser process from Stamicarbon S.A., a supplier of urea production technology based in the Netherlands. By using these advanced technologies, Fudao Phase II has a designed production capacity of approximately 800,000 tonnes of urea per annum (on a 300-day basis). The granulating facility and underlying fluid-bed granulating technology for both Fudao Phase I and Fudao Phase II were imported from Norsk Hydro, a Norwegian company. The fluid-bed granulating technology is used in the final production stage of our granular urea products. For the properties of granular urea products, see "—Products—Principal products".

Tianye Plant was built in 1996. Tianye Chemical imported the main facilities and most of its auxiliary and support facilities, as well as its ammonia synthesis and urea production technologies, from European, Japanese and American suppliers. The plant utilizes technologies licensed from Kellogg for ammonia synthesis and technologies from SNAMPROGETTI (ammonia stripping) for urea synthesis. As of the Latest Practicable Date, Tianye Chemical had a designed annual production capacity for urea of 520,000 tonnes. The integrated production plant used residual oil as its principal raw material before undergoing an upgrade to use natural gas in October 2005. Tianye Plant uses a granulating tower to form the traditional prill urea as its final product. See "—Production process".

The table below provides the approximate designed annual production capacities as of the Latest Practicable Date, as well as the source of our natural gas supply and technology, and commencement date of mass production for each of our ammonia and urea production facilities:

	Designed annual capacity as of the Latest Practicable Date[1]		Technology source	Source of natural gas	Location	Commencement of mass production
	Ammonia	Urea				
	(tonnes)					
Fudao Phase I	300,000	520,000	• ICI-AMV (for ammonia synthesis) • SNAMPROGETTI (for urea production) • Norsk Hydro (for granulation)	Yacheng 13-1 Offshore Gasfield operated by CNOOC Limited	Dongfang, Hainan	1997
Fudao Phase II	450,000	800,000	• KBR (for ammonia synthesis) • Stamicarbon (for urea production) • Norsk Hydro (for granulation)	Dongfang 1-1 Offshore Gasfield operated by CNOOC Limited	Dongfang, Hainan	2004
Tianye Plant	300,000	520,000	• Kellogg (for ammonia synthesis) • SNAMPROGETTI (for ammonia stripping and tower granulation)	Changqing Onshore Gasfield operated by PetroChina	Huhhot, Inner Mongolia	1997
Total	1,050,000	1,840,000				

(1) According to the industry norm in China for the urea industry, the designed annual capacity is measured as daily production capacity multiplied by 300 days per year.

We have implemented an efficient and effective maintenance system for our equipment and facilities in order to operate our production facilities at full capacity. Neither we nor Tianye Chemical have experienced any material or prolonged suspension of production at our facilities due to equipment or facility failure during the Track Record Period. The production facilities, as well as the granulating equipment, are regularly inspected and maintained by our maintenance teams to ensure that they are in proper working order. Our production facilities in Hainan are also subject to scheduled inspections and maintenance every 12 to 18 months and are shut down for up to 30 days during this scheduled maintenance. We seek to minimize interruption to the operation of our facilities. Our Fudao Phase I has achieved a record of 214 days of continuous production, while our Fudao Phase II and Tianye Plant have previously experienced a record of 169 days and 106 days of continuous production, respectively.

The following table sets forth information on the urea production volume and utilization rates for our urea facilities during the periods indicated:

	2003		2004		2005		Three months ended 31 March 2006	
	Production volume	Utilization[1]	Production volume	Utilization[1]	Production volume	Utilization[1]	Production volume	Utilization[3]
	(Tonnes)	(%)	(Tonnes)	(%)	(Tonnes)	(%)	(Tonnes)	(%)
Fudao Phase I	602,373	115.8	618,888	119.0	535,881	103.1	122,091	93.9
Fudao Phase II	—[2]	—	794,051	99.3	825,132	103.1	151,603	75.8
Tianye Plant	570,228	109.7	583,650	112.2	491,322	94.5	159,664	122.8

(1) Equal to the percentage of actual annual production volume over designed annual production capacity. According to the industry norm in China for the urea industry, the designed annual production capacity is measured as daily production capacity multiplied by 300 days per year.

(2) In 2003, facilities at Fudao Phase II were in trial operation and all revenues generated by Fudao Phase II in 2003 were used to partially offset the cost of testing its functionality during the trial operation period.

(3) Equal to the percentage of actual annual production volume over designed annual production capacity. According to the industry norm in China for the urea industry, the designed annual production capacity is also measured as daily production capacity multiplied by 90 days per quarter.

We upgrade our production equipment concurrently with the scheduled repair and maintenance from time to time to increase the life span and the efficiency of our production equipment.

Tianye Chemical's Methanol Plant

Tianye Chemical commenced construction of its methanol plant in March 2004 and completed the construction in December 2005. Tianye Chemical employs technologies licensed by domestic chemical technology developers, principally consisting of (i) a steam converter, (ii) a Linda JW uniform temperature methanol reactor, (iii) three tower in-line methanol distillers and (iv) a hydrogen and carbon dioxide recycler. As of the Latest Practicable Date, the designed annual production capacity of Tianye Chemical's Methanol Plant was 200,000 tonnes of methanol. See "—Production process—Joint Urea and Methanol Production at Tianye Plant".

The table below provides the approximate designed annual production capacity as of the Latest Practicable Date, as well as the source of our technology and natural gas supply and the commencement date of mass production of Tianye Chemical's methanol plant:

Designed annual capacity as of the Latest Practicable Date[1]	Technology source	Source of natural gas	Location	Commencement of mass production
(tonnes of methanol)				
200,000	Hangzhou Linda Chemical Technology Engineering Corporation Nanhua (Group) Corporation	Changqing Onshore Gasfield operated by PetroChina	Huhhot, Inner Mongolia	2006

(1) According to the industry norm in China for the methanol industry, the designed annual production capacity is measured as daily production capacity multiplied by 300 days.

CNOOC Jiantao Methanol Plant

Through CNOOC Jiantao, we constructed a large-scale methanol plant at our production complex in Hainan. The new CNOOC Jiantao Methanol Plant commenced trial production in September 2006. Mass production is not expected to commence until January 2007. CNOOC Jiantao did not produce or sell methanol or any methanol derivatives during the Track Record Period.

The total investment required to construct CNOOC Jiantao Methanol Plant is estimated to be approximately RMB1.5 billion. As of 31 March 2006, we and Hong Kong Kingboard had collectively contributed RMB500.0 million to this project.

CNOOC Jiantao deploys advanced methanol technologies and facilities manufactured by Lurgi Group, a German engineering and contracting company. Upon commencement of mass production, we expect CNOOC Jiantao Methanol Plant will be one of China's largest methanol production facilities in terms of its designed production capacity, with an expected designed production capacity of 600,000 tonnes of methanol per annum (on a 300-day basis). Once CNOOC Jiantao commences mass production, it is intended that no less than 400,000 tonnes of methanol per annum will be supplied to Hong Kong Kingboard for its own usage and consumption.

The table below provides the approximate designed annual production capacity upon commencement of mass production, as well as the source of our technology and natural gas supply and the expected commencement date of mass production of our methanol production facility at CNOOC Jiantao Methanol Plant:

Designed annual capacity as of the upon completion[(1)] (tonnes of methanol)	Technology source	Source of natural gas	Location	Expected Commencement of mass production
600,000	Lurgi Group (for methanol production)	Dongfang 1-1 Gasfield operated by CNOOC Limited	Dongfang, Hainan	January 2007

(1) The designed annual production capacity is measured as daily production capacity multiplied by 300 days per year.

Compound Fertilizer Production Facilities

The operations of our compound fertilizer production facility in Hainan, where we produce different blends of nitrogenous, phosphate and potash fertilizers according to our customers' specifications and needs, recommenced on 8 August 2006. We source the urea used for production of our compound fertilizer products from our own Hainan urea production facilities, located nearby. With its current technology, the facility has a designed annual production capacity of 50,000 tonnes of compound fertilizers per annum.

CO_2 Plant

We have constructed a new CO_2 Plant at our production complex in Hainan through our 100%-owned subsidiary, CNOOC (Hainan) E&P Gas Limited (中海石油(海南)環保氣體有限公司). CNOOC (Hainan) E&P Gas Limited commenced operation of the plant in February 2006 and, as of the Latest

Practicable Date, the plant was in trial operation. The plant uses gaseous emissions from Fudao Phase II and has a designed production capacity of 30,000 tonnes of liquid carbon dioxide per annum. Total planned capital expenditures for the new CO_2 Plant was RMB24.9 million. As of 31 March 2006, CNOOC (Hainan) E&P Gas Limited had invested RMB19.8 million in the plant. Carbon dioxide is a by-product of ammonia production. In liquid form it is produced by compressing and cooling the gas to approximately -37°C. Our new CO_2 Plant is also designed to produce dry ice, the solid form of carbon dioxide.

Future Facilities

Polyoxymethylene Production Facility

We plan to construct a production facility for the manufacture of polyoxymethylene at Tianye Plant, which will use methanol produced by Tianye Chemical as its principal raw material. The construction is expected to start in November 2006 and is expected to be completed by November 2008. The investment in the construction project is expected to be approximately RMB1,410.0 million. Upon completion, the new production facility is planned to have an annual production capacity of 60,000 tonnes of polyoxymethylene.

Potential Facilities

Additional Methanol Production Facility

In addition to Tianye Chemical's methanol production plant and our methanol production facility constructed by CNOOC Jiantao, we also plan to construct an additional methanol production facility at our Hainan production complex. The project is currently in its preliminary planning stages and, as of the Latest Practicable Date, we had not obtained any of the governmental approvals or permits required for the proposed project. Subject to obtaining such governmental approvals and permits, we currently contemplate that construction of the facility will commence in early 2007, with a view to commencing mass production in 2008. The investment in the construction project is expected to be approximately RMB2.4 billion to be funded from cash and cash equivalents generated from operating activities and external borrowings, and not from the proceeds of the Global Offering. Upon completion, the new production facility will have a designed annual production capacity of 1.13 million tonnes of methanol, produced using natural gas as the principal raw material.

PRODUCTION PROCESS

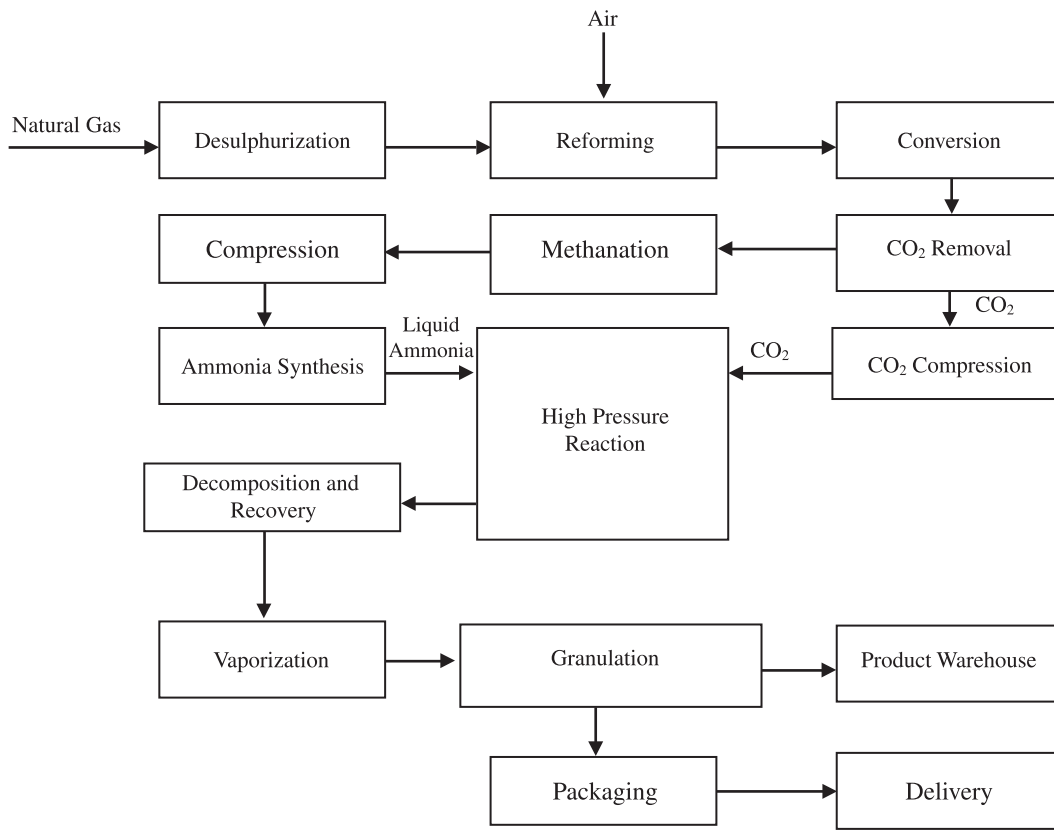
Synthetic Ammonia and Urea Production Process in Hainan

In each of our integrated ammonia and urea production facilities in Hainan, we produce synthetic ammonia through a process that includes desulphurization, reforming, conversion, CO_2 removal, methanation, compression of synthesized gas, ammonia synthesis, refrigeration and recovery. Our energy-efficient ammonia facilities utilize advanced and reliable technology with low natural gas consumption, ensuring stable operation of our plant even during operation at full capacity. The process requires low maintenance costs and provides high reliability.

Urea is commercially produced from two raw materials, namely ammonia and carbon dioxide. We obtain the ammonia from our synthesized ammonia facilities, while our carbon dioxide comes from the by-products of the ammonia production process. Under high pressure, ammonia and carbon dioxide undergo an incomplete reaction to produce urea. Unconverted reactants are recovered for

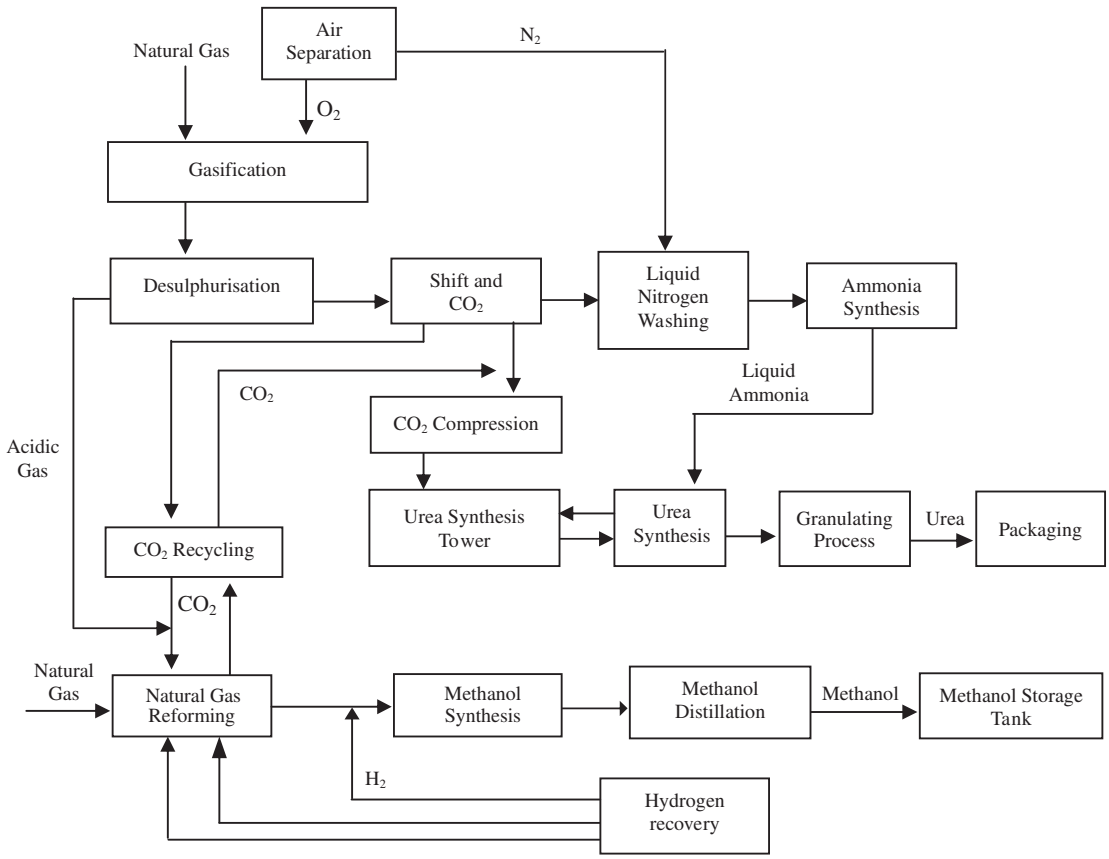
re-use in the production process. The various urea processes are characterized by the conditions under which urea formation takes place and the way in which unconverted reactants are further processed. Processes of our urea production facilities include CO_2 compression, high-pressured reaction, decomposition and recovery, vaporization, granulation, process condensate treatment.

The following flow chart provides a general overview of the integrated ammonia and urea production process at our production facilities in Hainan:



Joint Urea and Methanol Production at Tianye Plant

We employ the low-pressure synthesis process to produce distilled methanol and urea jointly at Tianye Plant. The joint urea and methanol production process includes the production of urea through CO_2 compression, the urea synthesis and granulating process, and the production of methanol through natural gas reforming, methanol synthesis and methanol purification, as illustrated in the following flow chart:



Unlike our urea granulating technology used in Fudao Phase I and Fudao Phase II, Tianye Plant employs granulating tower technology to produce traditional prill urea products. The granulating tower facility and technology were imported from and licensed by SNAMPROGETTI, an Italian chemical equipment and technology provider.

RAW MATERIALS AND ENERGY

Natural Gas

Natural gas is the primary feedstock for our production of ammonia and methanol. Purchases of natural gas therefore represent the most significant cost component of our cost of production. See "Financial Information—Management's discussion and analysis of financial condition and results of operations".

We source 100% of the natural gas consumed in our production facilities in Hainan from the offshore gasfields owned and operated by our affiliated company, CNOOC Limited. We source natural gas from onshore gasfields in northwestern China for the production at Tianye Plant. The following table sets forth information relating to natural gas supply for Fudao Phase I, Fudao Phase II and Tianye Plant:

	Designed annual consumption of natural gas	Actual consumption of natural gas				Gasfield	Operator of gasfield
		Year ended 31 December			Three months ended 31 March		
		2003	2004	2005	2006		
	(million m^3)	(million m^3)			(million m^3)		
Fudao Phase I	356	410	418	372	87	Yacheng 13-1	CNOOC Limited
Fudao Phase II	769	263(1)	790	862	158	Dongfang 1-1	CNOOC Limited
Tianye Plant							
Urea	253	—	—	60	77	Changqing	PetroChina
Methanol	183	—	—	12(1)	39(1)	Changqing	PetroChina

(1) On trial operation

We have entered into long-term natural gas sale and purchase agreements on a take-or-pay basis with CNOOC Limited, our affiliate, and Fuel & Chemical Corporation of Hainan, an Independent Third Party, to secure stable and reliable supplies of natural gas for our production in Hainan. The agreements set out such details as the specification and quality standard of the natural gas, the mechanisms for ascertaining the quantity of natural gas to be supplied, the conditions under which natural gas is delivered, the standards of gauging the quantity of natural gas supplied and examining the related facilities, payment obligations, tax liabilities, events of force majeure, dispute resolution methods, liabilities for breaching the agreements and confidentiality obligations. Further, under the take-or-pay arrangement in the agreements, CNOOC Limited and Fuel & Chemical Corporation of Hainan (as applicable) are obliged to supply and we are obliged to purchase a minimum quantity of natural gas each year.

Under the terms of our natural gas sale and purchase agreements, the prices at which natural gas is supplied to our production facilities in Hainan are determined by the following mechanism:

(a) The prices are subject to upward or downward adjustments on a quarterly basis in the case of Fudao Phase I and Fudao Phase II, and on a monthly basis in the case of CNOOC Jiantao Methanol Plant.

(b) The applicable quarterly or monthly price (as the case may be) is determined by reference to the prevailing crude oil price quoted by Platts Crude Oil Marketwire (which reflects the average of four major types of crude oil prices in the international market, namely, ¼ of the West Texas Intermediate crude oil price, ¼ of Dubai crude oil price, ¼ of Brent crude oil price and ¼ of Minas crude oil price in the case of Fudao Phase I; and ¼ of the West Texas Intermediate crude oil price, ¼ of Tapis crude oil price, ¼ of Brent crude oil price and ¼ of Minas crude oil price in the case of Fudao Phase II and CNOOC Jiantao Methanol Plant).

(c) Our natural gas price for the relevant quarter or month (as the case may be) is also subject to a cap and a floor determined in the following manner: Where the result calculated according to paragraph (b) above exceeds the last quarterly or monthly price (as the case may be) multiplied by a fixed numerical value (which is greater than one), then the applicable price will be capped at an amount that equals the last periodical price multiplied by that numerical value. Where the result calculated according to paragraph (b) above is less than the last quarterly or monthly price (as the case may be) multiplied by another fixed numerical value (which is less than one), then the applicable price will be set at an amount that equals the last periodical price multiplied by that numerical value.

(d) If the four major types of crude oil prices referred to in paragraph (b) above no longer reflect global crude oil prices or if Platts Crude Oil Marketwire ceases to quote crude oil prices, then our natural gas price will be determined by the relevant supplier and us on the principle of providing reasonable adjustments to natural gas prices in general and taking into account the level and trend of fuel prices in the PRC market.

We believe that such pricing mechanism can on one hand reflect movements in fuel prices in the international markets and on the other hand effectively limit the extent of adjustments to our natural gas prices, thus helping us to limit the impact of fuel price volatility in the global market on the costs of our natural gas purchases. The redacted copies of our long-term Hainan natural gas sale and purchase agreements will be made available for public inspection. See Appendix IX to this Prospectus.

Our Hainan production facilities have experienced a few interruptions in natural gas supply during the Track Record Period due to severe weather that forced our natural gas suppliers to shut down offshore drilling platforms and transportation pipelines for maintenance. We did not incur any material loss as a result of such interruptions. Since their conversion to utilize natural gas as the principal raw material in October 2005, Tianye Chemical's production facilities have not experienced any interruptions in natural gas supply. See "Risk Factors—Risks relating to our business operations—Our operations are subject to operating hazards and natural disasters that may not be fully covered by our insurance policies" and "—Our operating results may be significantly affected by changes in the supply of natural gas as a critical raw material."

For Fudao Phase I

Natural gas is supplied from Yacheng 13-1 Gasfield, a gasfield owned by CNOOC Limited, BP and KUFPEC, to Fuel & Chemical Corporation of Hainan (海南省燃料化學總公司), an Independent Third Party, which in turn supplies natural gas to Fudao Phase I on a take or pay basis. Pursuant to a 20-year natural gas sale and purchase agreement between the predecessor of CNOOC Fudao and Fuel & Chemical Corporation of Hainan, which was subsequently assumed by CNOOC Chemical, our predecessor, and us, Fuel & Chemical Corporation of Hainan is committed to supply us with natural gas as feedstock for the production of urea at Fudao Phase I. The term of the agreement will expire in 2016. We are currently negotiating the committed supply volume with Fuel & Chemical Corporation of Hainan. See "Risk Factors—Risks relating to our business operations—Our operating results may be significantly affected by changes in the supply of natural gas as a critical raw material."

Fudao Phase I was designed to consume natural gas sourced from Yacheng 13-1 Gasfield. CNOOC Limited owns a 51% interest in Yacheng 13-1 Gasfield. As of 31 December 2005, Yacheng 13-1 Gasfield was one of CNOOC Limited's largest gasfields in terms of production. As of 31 December 2005, Yacheng 13-1 Gasfield had 843.3 Bcf, equivalent to approximately 24.2 billion

m^3, of natural gas reserves and produced an average of 254.9 Mmcf, equivalent to approximately 7.3 million m^3, of natural gas per day. CNOOC Limited transports the natural gas to Fuel & Chemical Corporation of Hainan through an undersea pipeline connecting the gasfield and Sanya City, Hainan Province. Fuel & Chemical Corporation of Hainan in turn supplies natural gas to us through a 116-kilometer long underground pipeline.

For Fudao Phase II

CNOOC Limited supplies natural gas directly to us for urea production at Fudao Phase II on a take or pay basis pursuant to a 20-year natural gas sale and purchase agreement between CNOOC Limited and us. Our natural gas sale and purchase agreement for Fudao Phase II will expire on 30 September 2023.

CNOOC Limited supplies us with natural gas of the heat value of 23,450KJ from its wholly owned and operated Dongfang 1-1 Gasfield. We designed Fudao Phase II to use the natural gas from Dongfang 1-1 Gasfield. As of 31 December 2005, Dongfang 1-1 Gasfield was CNOOC Limited's largest gasfield in terms of net proved reserves. As of 31 December 2005, Dongfang 1-1 Gasfield had 1,320.4 Bcf, equivalent to approximately 37.4 billion m^3, of natural gas reserves. As of 31 December 2005, the daily production of Dongfang 1-1 Gasfield was 92.0 Mmcf, equivalent to approximately 2.6 million m^3, of natural gas. CNOOC Limited transports the natural gas directly to our production complex in Hainan through an undersea pipeline.

For the years ended 31 December 2003, 2004 and 2005 and the three months ended 31 March 2006, Fudao Phase I and Fudao Phase II consumed an aggregate of approximately 409.8 million m^3, 1,208.0 million m^3, 1,233.8 million m^3 and 245.6 million m^3 of natural gas, respectively.

For Tianye Plant

The Tianye Plant ceased using residual oil and began using natural gas as the key raw material for the production of its products in 2005. Tianye Chemical purchases natural gas from Inner Mongolia Western Natural Gas Co., Ltd., an Independent Third Party and pipeline operator that sources natural gas from PetroChina. PetroChina supplies natural gas from its onshore gasfields, Changqing Gasfields, to Inner Mongolia Western Natural Gas Co., Ltd. which in turn supplies natural gas to Tianye Plant. The Changqing Gasfields cover parts of Shaanxi Province and Gansu Province, as well as the Ningxia and Inner Mongolia Autonomous Regions of the PRC. Since Tianye Chemical started utilizing natural gas as its principal raw material for the production of urea on 26 October 2005 and methanol on 11 December 2005, it purchased a total of 72 million m^3 of natural gas in 2005. As of 31 December 2005, the Changqing Gasfields' known reserves were 15,765.6 Bcf, equivalent to approximately 446.5 billion m^3 with an annual natural gas production of 233.9 Bcf, equivalent to approximately 6.6 billion m^3. Inner Mongolia Western Natural Gas Co., Ltd., a transporter and distributor of natural gas produced by PetroChina, transports the natural gas from the Changqing Gasfields directly to Tianye Plant at Huhhot through a gas pipeline.

Tianye Chemical entered into an agreement in 2005 with Inner Mongolia Western Natural Gas Co., Ltd. to purchase 600 million m^3 of natural gas per annum. The commitment of natural gas supply pursuant to the agreement with Inner Mongolia Western Natural Gas Co., Ltd. is based on the assumption that PetroChina will supply natural gas to Inner Mongolia Western Natural Gas Co., Ltd. without interruptions. Neither we nor Tianye Chemical have entered into any long-term agreement

with PetroChina regarding the quantity or quality of natural gas supply. However, the government of Inner Mongolia Autonomous Region committed to assist us in securing natural gas from PetroChina in case of shortage. See "Risk Factors—Risks relating to our business operations—Our operating results may be significantly affected by changes in the supply of natural gas as a critical raw material."

For CNOOC Jiantao Methanol Plant

We source natural gas as our principal raw material for the production of methanol at CNOOC Jiantao Methanol Plant directly from CNOOC Limited's Dongfang 1-1 Gasfield, the same gasfield from which we source natural gas for our production at Fudao Phase II. We have entered into a 20-year natural gas sale and purchase agreement with CNOOC Limited to purchase natural gas at a consistent supply volume per annum for the production of methanol. Our natural gas sale and purchase agreement for CNOOC Jiantao Methanol Plant will expire in 2026.

We designed CNOOC Jiantao Methanol Plant to use natural gas from Dongfang 1-1 Gasfield, exclusively. See "—For Fudao Phase II" for information relating to Dongfang 1-1 Gasfield.

Methanol

A substantial proportion of our granular urea products produced at Fudao Phase I and Fudao Phase II are blended with a formaldehyde solution as part of our anti-agglomerate chemical technology. Approximately 14.9 kilograms of formaldehyde are required to blend with one tonne of urea products. We purchase methanol as the raw material for the production of formaldehyde, which we then process in our facilities. One tonne of methanol is required to produce 2.3 tonnes of formaldehyde. In 2005, we purchased approximately 9,000 tonnes of methanol from Ningbo Long Xiang Chemical Industry International Trade Co., Limited, an Independent Third Party. We expect to cease purchasing methanol from third-party suppliers after the commencement of trial production at CNOOC Jiantao Methanol Plant in September 2006.

Plastic Resins

We purchase various types of plastic resins, which mainly include PP and HDPE, for the production of woven plastic bags at our production facilities in both Hainan and Inner Mongolia. Woven plastic bags are important packaging materials for our granular and traditional prill urea sold in domestic markets. These plastic materials are generally available from multiple sources. As part of our risk-avoidance strategy, we aim to diversify the sources of the plastic materials in order to enjoy cost benefits and steady supply and to avoid the risk that comes with reliance on a single source of supply.

Electricity

We purchase the electricity used in our production and other business operations in Hainan from the local power grid. For the years ended 31 December 2003, 2004 and 2005 and the three months ended 31 March 2006, we purchased 110.7 million Kwh, 236.0 million Kwh, 239.8 million Kwh and 57.1 million Kwh of electricity for our operations in Hainan at RMB49.5 million, RMB111.4 million, RMB121.9 million and RMB30.3 million, respectively, from Hainan Branch of China South Power Grid Co., Ltd. (中國南方電網有限公司海南分公司). We have not experienced any material shortages of electricity, except for occasional stoppages of power of limited duration due to severe weather that did not materially impact our production. See "Risk Factors—Risks relating to our business operations—Our operations are subject to operating hazards and natural disasters that may not be fully

covered by our insurance policies" and "Risk Factors—Risks relating to the PRC—Electricity shortages in China may lead to reduced economic growth".

Our Tianye Plant also requires a significant amount of electricity and steam for its daily operations and production. Tianye Plant has its own coal-fired power generation systems at its production complex, providing both electric power and steam heat to all of its production facilities, thereby saving energy costs.

As of the Latest Practicable Date, we had a coal-fired cogeneration unit at Tianye Plant with an aggregate installed capacity of 16,000 KW. In addition to electricity, the power plants also produce steam used in the production process. As of the Latest Practicable Date, the power plants supplied approximately 60% of the electricity required for Tianye Plant's operations. The remainder of our electricity requirements in Huhhot was met with supplies from the Northern China power grid. For the years ended 31 December 2003, 2004 and 2005, and the three months ended 31 March 2006, Tianye Chemical purchased 27.0 million Kwh, 46.4 million Kwh, 52.7 million Kwh and 10.6 million Kwh of electricity, respectively, from the local power grid and incurred electricity costs of RMB9.7 million, RMB14.0 million, RMB14.1 million and RMB3.6 million, respectively. Tianye Chemical has not experienced any material shortages of electricity except for occasional stoppages of power caused by severe weather; however, such stoppages did not have a material impact on its production.

Coal

We source thermal coal for Tianye Plant's production from suppliers that we anticipate can provide a stable and reliable supply at low cost. For the years ended 31 December 2003, 2004 and 2005 and the three months ended 31 March 2006, Tianye Chemical purchased 341,581 tonnes, 405,735 tonnes 334,339 tonnes and 60,008 tonnes of thermal coal, respectively, from several suppliers at a cost of RMB32.3 million, RMB43.0 million and RMB75.9 million and RMB17.1 million, respectively.

Water

In Hainan, we have entered into a long-term water supply agreement with Hainan Xingshui Town and Country Water Supply Co., Limited (海南興水城鄉供水有限公司). Based on the agreement, the water company supplies us with water for a price of RMB0.43 per tonne based on the assumption that our daily consumption will be no more than 60,000 tonnes. In the event that our consumption of water exceeds 60,000 tonnes per day, we will negotiate the unit price with Hainan Xingshui Town and Country Water Supply Co., Limited on a case-by-case basis.

The source of water supply mainly includes Daguangba Reservoir (大廣壩水庫), which has a water reserve capacity of 1.7 billion m^3. We did not experience any material water shortages that interrupted our production during the Track Record Period. The average daily consumption of water at our Hainan facilities for the years ended 2003, 2004 and 2005 and three months ended 31 March 2006 was approximately 14,360 tonnes, 27,623 tonnes, 29,585 tonnes and 25,036 tonnes, respectively. We expect that the total consumption of water at our Hainan facilities after the completion of CNOOC Jiantao Methanol Plant will be no more than 50,000 tonnes per day.

Throughout the Track Record Period, Tianye Chemical obtained water for Tianye Plant's operations from wells owned and operated by it within its production complex. Since 2006, Tianye Chemical started purchasing water from the local water company. According to the water purchase

agreement, the local water company is committed to supply water to our Tianye Plant sourced from the mid-stream of the Yellow River. During the Track Record Period, Tianye Chemical did not experience any water shortages.

Largest Suppliers

For the years ended 31 December 2003, 2004 and 2005 and the three months ended 31 March 2006, purchases from our five largest suppliers accounted for approximately 77.2%, 81.8%, 79.3% and 80.3%, respectively, of our total purchases, and purchases from our largest supplier accounted for approximately 57.7%, 39.1%, 40.3%, and 27.1%, respectively, of our total purchases. Fuel & Chemical Corporation of Hainan, which sourced the natural gas supplied to Fudao Phase I from CNOOC Limited, was our largest supplier for 2003, supplying natural gas, and CNOOC China Limited, a subsidiary of CNOOC Limited, was our largest supplier for the years 2004 and 2005, and the three months ended 31 March 2006 supplying natural gas. Apart from CNOOC China Limited, none of our Directors, Supervisors, senior management, their Associates, or any shareholders holding more than 5% of the issued share capital of our Company had any interest in any of our five largest suppliers for the three years ended 31 December 2003, 2004 and 2005 and the three months ended 31 March 2006.

For the years ended 31 December 2003, 2004 and 2005, purchases from Tianye Chemical's five largest suppliers accounted for approximately 79.1%, 71.4% and 83.1%, respectively, of its total purchases, and purchases from Tianye Chemical's largest supplier accounted for approximately 47.6%, 48.2% and 38.8%, respectively, of its total purchases. PetroChina Huhhot Petrochemical Company (中國石油天然氣股份有限公司呼和浩特石化分公司) was Tianye Chemical's largest supplier for the years ended 31 December 2003, 2004 and 2005, supplying Tianye Chemical with residual oil, while Inner Mongolia Western Natural Gas Co., Ltd. was Tianye Chemical's largest supplier of natural gas for 2005. None of Tianye Chemical's Directors, Supervisors, senior management, their Associates, or any shareholders holding more than 5% of the issued share capital of Tianye Chemical had any interest in any of the five largest suppliers of Tianye Chemical for the years ended 31 December 2003, 2004 and 2005.

SALES AND MARKETING

Sales of Urea Products

We sell most of our urea products domestically and overseas to wholesale customers and directly to a limited number of other customers. Due to geographical segregation and product differences, we maintain two sales channels to sell and market our urea products produced at Hainan and Inner Mongolia. Our wholesale customers purchase our urea products and resell them to end customers for agricultural, horticultural and other planting purposes. Substantially all of our end customers who purchase urea products directly from us use them for industrial purposes.

As of the Latest Practicable Date, the wholesale customers who purchased our granular urea products produced at Hainan principally consisted of seven regional wholesalers, two international wholesalers and 14 local wholesalers. In addition, 29 wholesale customers purchased our traditional prill urea products produced at Tianye Plant. We did not make any export sales during the three months ended 31 March 2006 because the government imposed a seasonal tariff on exports. However, we did not experience any loss of customers during the same period.

The following table sets out the volume of our and Tianye Chemical's urea products sold to various categories of customer during the Track Record Period:

	2003		2004		2005		Three months ended 31 March 2006	
	Volume (Tonnes)	Percentage (%)	Volume (Tonnes)	Percentage (%)	Volume (Tonnes)	Percentage (%)	Volume (Tonnes)	Percentage (%)
Our Company								
To international wholesalers	243,713	42.6%	541,144	39.2%	178,380	13.1%	0[1]	0.0%[1]
To regional wholesalers	208,807	36.5%	651,704	47.2%	979,514	71.8%	224,816	80.8%
To local wholesalers	86,515	15.1%	102,260	7.4%	124,646	9.1%	38,091	13.7%
To other customers[2]	33,241	5.8%	84,798	6.2%	82,067	6.0%	15,282	5.5%
Tianye Chemical								
To wholesalers	488,991	90.1%	610,352	91.9%	441,964	98.3%	175,651	99.0%
To other customers[2]	54,024	9.9%	54,157	8.1%	47,275	9.7%	1,732	1.0%

(1) See "Financial Information—Management's Discussion and Analysis of Financial Condition and Results of Operations—Factors affecting our results of operations and financial condition—Taxation—Value added tax and tariffs on export sales".

(2) Other customers are the purchasers of our and Tianye Chemical's products not for resale purposes.

The following map illustrates the areas covered by our distribution network in the PRC:

Customers

During the Track Record Period, a substantial amount of our and Tianye Chemical's sales was made to wholesalers of fertilizer products. The wholesalers purchase our urea products and resell them to their customers in their designated distribution territories.

Sales of products produced in Hainan. The following table sets forth our sales volume based on the geographical location of our customers during the Track Record Period:

	Year ended 31 December						Three months ended 31 March	
	2003		2004		2005		2006	
	Volume (Tonnes)	Percentage (%)	Volume (Tonnes)	Percentage (%)	Volume (Tonnes)	Percentage (%)	Volume (Tonnes)	Percentage (%)
Sales in Northern China	29,140	5.1	154,576	11.2	219,604	16.1	38,491	13.8
Sales in Eastern China	50,836	8.9	176,033	12.8	279,790	20.5	52,520	18.9
Sales in Southeastern China	39,482	6.9	128,379	9.3	151,923	11.1	33,102	11.9
Sales in Southern China	93,249	16.3	226,747	16.4	358,716	26.3	100,703	36.2
Sales in Hainan	115,856	20.2	153,028	11.1	176,195	12.9	53,373	19.2
International	243,713	42.6	541,144	39.2	178,380	13.1	0	0.0
Total	572,276	100.0	1,379,906	100.0	1,364,607	100.0	278,189	100.0

We consider the business scale, financial conditions, market share, level of sales and storage capacity of our wholesale customers when entering into sales agreements. We have long-term relationships with our current regional and international wholesale customers, but not our local wholesale customers as we now focus our efforts on direct sales in Hainan Province. Each of our wholesale customers is subject to annual performance and credit reviews.

- *Regional wholesalers*

Our seven principal regional wholesale customers resell our granular urea products produced in Hainan to end users throughout 9 provinces in China, except for Hainan Province which is principally covered by 14 local wholesalers. In addition to the seven principal regional wholesale customers, we also made sales to other wholesale customers from time to time. The main areas in which our regional wholesale customers resell our granular urea products produced in Hainan include the coastal provinces of China, such as Guangdong, Guangxi, Fujian, Zhejiang and Jiangsu Provinces. The regional wholesale customers' sales centers are focused on sales to retailers and end-users of fertilizer products, including our urea products. For the years ended 31 December 2003, 2004 and 2005 and the three months ended 31 March 2006, approximately 36.5%, 47.2%, 71.8% and 80.8%, respectively, of our total net sales of granular urea products by volume from Hainan were to regional wholesalers.

- *International wholesalers*

The export of fertilizers, including our urea products, is not subject to any quota prescribed by the PRC Government. For the years ended 31 December 2003, 2004 and 2005, approximately 42.6%, 39.2% and 13.1%, respectively, of our total net sales of granular urea products by volume produced in Hainan were from export sales to international wholesalers. For the three months ended 31 March 2006, we did not make any sales internationally. We sell substantially all of our urea products for export to two international wholesalers, Itochu Corporation and Transammonia for resale to their customers in Japan and elsewhere in the world, respectively.

- *Local wholesalers*

We further divide the market for our urea products in Hainan Province into 14 areas and sell our urea products principally to 14 local wholesale customers for resale in Hainan Province through more than 550 local outlets. For the years ended 31 December 2003, 2004 and 2005 and the three months ended 31 March 2006, approximately 15.1%, 7.4%, 9.1% and 13.7%, respectively, of our total net sales of granular urea products by volume from Hainan were to local wholesalers.

Largest customers

We sell our products to our shareholders, Zhejiang AMP, Guangdong AMP and Shanghai AMP as our regional wholesale customers for Zhejiang and Guangdong Provinces and Shanghai City, respectively, whereas Transammonia, also our shareholder, is one of our international wholesale customers. We also have a 30% equity interest in Guangxi Fudao AMP, our regional wholesaler in Guangxi Province, in which Zhejiang AMP holds the remaining equity interest.

For the years ended 31 December 2003, 2004 and 2005 and the three months ended 31 March 2006, sales to our five largest customers, all of whom were our wholesale customers, accounted for approximately 68.2%, 54.8%, 48.9% and 32.7% of our total revenue, respectively, and sales to the largest customer accounted for approximately 37.3%, 31.4%, 14.8% and 11.0%, respectively, of our total revenue.

The largest customer of our urea products produced in Hainan for the years ended 31 December 2003, 2004 and 2005 was Transammonia, also our largest international wholesaler who purchased our urea products and resold them to customers in Southeast Asian countries, Australia, New Zealand, Korea and the United States. None of our Directors, Supervisors, senior management, their Associates, or any shareholders holding more than 5% of the issued share capital of our Company had any interest in any of our five largest customers for the years ended 31 December 2003, 2004 and 2005 and the three months ended 31 March 2006 other than interests held through us in Guangxi Fudao AMP, which was our third largest customer in 2005, accounting for approximately 8.5% of our total revenue in 2005.

Sales of products produced in Inner Mongolia. As of the Latest Practicable Date, we had 29 wholesale customers who purchased products from our Tianye Plant, all of which were domestic customers. For the Track Record Period, Tianye Chemical sold substantially all of its products to wholesale customers. Consistent with what we consider is the industry practice in the northern China region, Tianye Chemical does not have any long-term contract with its customers.

For the years ended 31 December 2003, 2004 and 2005, the five largest customers of Tianye Chemical accounted for approximately 46.1%, 38.5% and 45.5% of its total revenue, respectively, and the largest customer accounted for approximately 20.9%, 10.8% and 22.1% of its total revenue, respectively.

Tianye Chemical's largest customer during the Track Record Period was Inner Mongolia Agricultural Means of Production Company (內蒙古農牧業生產資料有限公司), which is an Independent Third Party. None of our Directors, Supervisors, senior management, their Associates or any shareholders holding more than 5% of our issued share capital of our Company had any interest in any of the five largest customers of Tianye Chemical for the Track Record Period.

Credit Policy

At present, all customers of our products from Hainan, both domestic and foreign except for our largest customers who are also our Promoters, are required to make full payment before delivery. In limited cases, we grant our largest customers, who are also our Promoters and who present credible commercial acceptance drafts, credit terms of up to 90 days. For export sales, our overseas customers generally provide us with letters of credit before we deliver our products to them. We will review our credit policy as necessary based on market conditions. As of the Latest Practicable Date, we had no doubtful debts from sales of our products.

We also adopt a stringent credit policy for our sales made in Inner Mongolia, pursuant to which the total amount of credit given to customers at any time shall not exceed a capped amount set and approved by Tianye Chemical. Tianye Chemical's sales department internally assesses the credit rating of each of its customers and the respective credit policy is adjusted accordingly. In general, customers are divided into three classes, namely no credit customers, low credit-rating customers and high credit-rating customers. Set out below is a summary of the credit control measures adopted by Tianye Chemical:

- *No credit customers*—no credit is generally given to new customers and customers with relatively low credit ratings. Such customers are required to make full payment before delivery.
- *Low credit-rating customers*—delivery is allowed to be made as long as there is sufficient evidence to show that payment will be made by the respective customers (such as bank guarantees) despite the fact that receipt of payment has not yet been confirmed by Tianye Chemical. Such customers usually enjoy a credit period given by Tianye Chemical of 30 to 60 days.
- *High credit-rating customers*—such customers usually enjoy a credit period given by Tianye Chemical of 45 to 90 days.

Pricing

The ex-factory prices of urea products in China are subject to price controls imposed by the PRC Government. Different price control measures with respect to ex-factory prices of fertilizers are imposed on large producers and medium- and small-sized producers, respectively. As a large producer, with a production capacity of ammonia for a single facility of over 150,000 tonnes, our average ex-factory price of urea products set by the NDRC or the relevant local development and reform commission was RMB1,500 per tonne and subject to a maximum of a 15% upward price adjustment as of the Latest Practicable Date. Export sales of our urea products are not subject to price control. The following table sets forth the average selling prices we achieved for our granular urea products for the years ended 31 December 2003, 2004 and 2005 and the three months ended 31 March 2006:

	Year ended 31 December			Three months ended 31 March
	2003	2004	2005	2006
	(RMB per tonne)			
NDRC base price[1]	1,400	1,400[2]	1,500	1,500
Average domestic sales price	1,287	1,476	1,650	1,591
Average export sales price	1,352	1,666	2,030	—

(1) In 2004 and 2005, the sales price of urea was subject to a ceiling of 10% above the base price. This has been adjusted to 15% since January 2006.

(2) NDRC adjusted the base price to RMB1,500 per tonne from December 2004.

Prices of our granular urea products sold in domestic markets are determined on an ex-factory basis and do not include freight, while export sales of our products are on an FOB basis. The prices of our urea products sold to different wholesale customers as well as end customers within the same period may differ due to market conditions, marketing, volume purchased and other administrative considerations. Pricing of our products is determined and regulated by our pricing sub-committee under our sales committee, consisting of the management from our sales and finance departments and our audit and supervision departments, which meets on a monthly basis and is subject to unscheduled meetings when market prices for urea or natural gas, as our key raw material, experience sudden fluctuations.

The price of Tianye Plant's traditional prill urea products is subject to price controls imposed by the PRC Government but on average was generally lower than that of our granular urea products from our Hainan production facilities during the years ended 31 December 2003, 2004 and 2005, but was slightly higher than the price of our granular urea products in the three months ended 31 March 2006. The following table sets forth the average selling prices Tianye Chemical achieved for its traditional prill urea products for the years ended 31 December 2003, 2004 and 2005 and the three months ended 31 March 2006:

	Year ended 31 December			Three months ended 31 March
	2003	2004	2005	2006
	(RMB per tonne)			
NDRC base price[1]	1,400	1,400	1,500[2]	1,500
Average domestic sales price	1,230	1,429	1,634	1,593

(1) In 2004 and 2005, the sales price of urea was subject to a ceiling of 10% above the base price. This has been adjusted to 15% since January 2006.

(2) NDRC adjusted the base price to RMB1,500 per tonne from December 2004.

On 24 February 2005, the NDRC in Inner Mongolia penalized Tianye Chemical for over-charging its customers RMB4.5 million in its sales of 48,168 tonnes of urea products. The local price supervisory agency confiscated part of the over-charged amount of RMB1.6 million that Tianye Chemical failed to refund to its customers before 20 April 2005 as an administrative penalty on 12 May 2005, and also ordered Tianye Chemical to refund the remaining amount over-charged, or RMB2.9 million, to its customers. See "Risk Factors—Risks relating to our business operations—Our acquisition agreements may not provide us with sufficient protection against liability for undiscovered acts of non-compliance arising from our prior acquisitions or future acquisitions".

Seasonality

Sales of our urea products are subject to seasonality. Our sales in the spring and summer seasons in the northern hemisphere are usually higher than the sales made in autumn and winter. However, we have managed to mitigate fluctuations in our revenue resulting from seasonality to a certain extent by making export sales through our international wholesalers to Australia and New Zealand in the southern hemisphere during their planting season, which coincides with the low season in the northern hemisphere, and to Southeast Asian countries, where sales are generally less affected by seasonality.

Sales of Methanol Products

We sell the majority of our methanol products produced in Inner Mongolia to wholesale customers for resale in the PRC market. A smaller portion of our methanol sales is made directly to customers located mainly in Southeast China. As of the Latest Practicable Date, none of the wholesale customers had entered into any long-term sales contract with Tianye Chemical. All sales are made on a spot contract basis.

After commencement of trial production at CNOOC Jiantao in September 2006, part of the methanol output may be supplied to Hong Kong Kingboard, our joint-venture partner and a 40% shareholder of CNOOC Jiantao. Upon commencement of mass production, expected in January 2007, it is intended that no less than 400,000 tonnes per annum will be supplied to Hong Kong Kingboard for its own usage or consumption. See "Connected Transactions—Kingboard Product Sales and Services Agreement".

CNOOC Jiantao plans to sell most of its methanol by way of direct sales, and a very limited amount of the remaining methanol to wholesalers, including our affiliate Guangxi Fudao AMP, for sale to customers in specific provinces in China. As of the Latest Practicable Date, CNOOC Jiantao had a sales and marketing team of eight personnel located mainly in our headquarters in Hainan.

Sales of methanol are not subject to PRC Government price control. Tianye Chemical prices its methanol and CNOOC Jiantao intends to price its methanol, mainly based on the market price taking into account their respective costs of production and delivery and volume purchased.

TRANSPORTATION OF PRODUCTS

Transportation of Products Produced in Hainan

We sell substantially all of our urea products produced in Hainan on an ex-factory basis pursuant to which our customers are responsible for shipment. Most of our customers engage our transportation and port services to ship our urea products by vessels, roadways and/or railways. We believe our efficient, convenient, reliable and integrated transportation, port and other logistics services meet the transportation requirements of our urea products customers as well as other customers.

We provide the following logistics and transportation services through Hainan CNOOC Transportation to our mineral fertilizer customers and other customers with logistical needs. We, by ourselves or through third parties, are also able to provide integrated, or turn-key, services that combine two or more of the following services for our customers' one-stop transportation requirements:

- Short-haul truck transportation services from our production complex to Basuo Port;
- Local transportation services;
- Rail transportation services;
- Domestic seagoing freight services; and
- Sea and land hazardous articles transportation services.

Ground Transportation Services

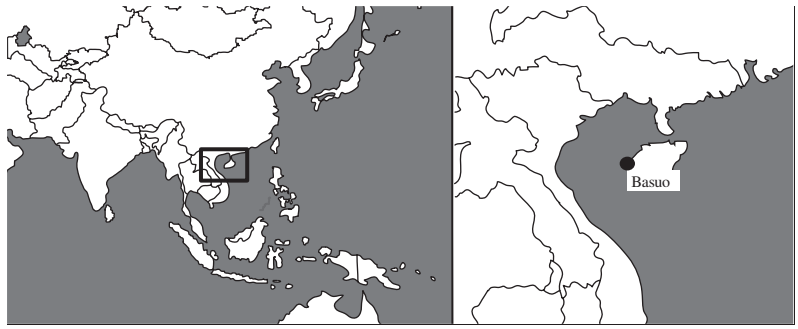
We provide ground transportation services to our urea customers who engage us for the transportation of our urea products, and also to other customers who engage us for the transportation of a wide range of other goods. Our transportation services include short-haul truck transportation from our production complex in Hainan to Port of Basuo by our own fleet of trucks. We also charter trucks and lease rail car capacity from third parties to satisfy our customers' inland and long-haul ground transportation needs. As of the Latest Practicable Date, we owned thirty 48-tonne trucks mainly to provide short-haul transportation services from our Hainan production facilities. From time to time, we also charter trucks from two truck service providers to transport urea products on a need basis.

Transportation Services by vessels

We assist our domestic customers in arranging for the transportation by vessels of a substantial amount of granular urea produced at Fudao Phase I and Fudao Phase II. However, such services are limited to customers located in areas with accessible seaports, waterways and canals. For the years ended 31 December 2003, 2004 and 2005 and the three months ended 31 March 2006, we shipped approximately 572,000 tonnes, 1,225,000 tonnes, 973,000 tonnes and 172,000 tonnes, respectively, or approximately 95.0%, 86.7%, 71.5% and 58.4% of the total volume of our urea products produced in Hainan, all of which were shipped from Port of Basuo. Substantially all wholesale customers and end customers who purchase our granular urea products from us engage us for the transportation of urea products.

We operate Port of Basuo, one of the main international and domestic oceangoing freight gateways to Hainan Province, located within five kilometers from our production complex in Hainan. Port of Basuo was built during the 1940s and has since undergone a number of upgrades. Port of Basuo

was designated as one of the first ports opened for international freight shipments following the opening of China to international trade in 1958. Situated on the east bank of Beibu Gulf in the South China Sea, it is one of the closest ports in China to international ports of major continents and countries along the Pacific Rim. The following maps illustrate the location of Port of Basuo:



Port of Basuo has six berths for vessels of 10,000 dwt and over and two berths for vessels of 1,000 dwt and over, including one 10,000 dwt berth exclusively reserved for the shipment of our granular urea products. It is the second largest deepwater seaport in Hainan Province in terms of freight throughput. It has been opened for navigation to, and has established trade contacts with, many large ports in mainland China and ports in more than 20 countries and regions. During the late 1990s, the reconstruction work of the breakwater and two new general cargo berths for vessels of 20,000 dwt were completed. The total land area of Port of Basuo is 0.8 km^2 and the total designed annual throughput capacity as of 31 December 2005 was 4.2 million tonnes.

Integrated Sea-Land Logistics Services

Since we own and operate Port of Basuo, we are able to provide customers of our granular urea products produced at our Hainan production facilities with integrated logistics services from warehousing and storage to truck transportation and oceangoing freight transportation. Most of these services are provided on a turn-key, or sea-land integrated, basis.

When our customers engage us to transport urea products produced at our Hainan production facilities on a sea-land integrated basis, we first transport the urea products to Port of Basuo by truck for loading onto vessels chartered by us. We charge our customers for the logistics services based on the distance and weight of shipment. We believe that our operations and close proximity to Port of Basuo, as well as our experience in logistics services, enable us to compete against other companies in the logistics service industry in transporting our urea products to our customers.

We also arrange and provide other customers with logistics services. We deliver miscellaneous goods as well as hazardous chemicals by chartered vessels for our customers based on their requirements.

We provide transportation services to non-urea customers based on fixed-term agreements. The agreements pre-determine the price for our services during the agreed term based on the weight of shipment and distance of shipment. The price for our services is based on the nature of goods, the means and distance of transportation, and general market conditions. In 2005, when we started operating the Port of Basuo, we generated total revenues of RMB38.8 million from the logistics services we provided to these other customers.

Future Methanol Transportation

We plan to deliver most of our liquid methanol produced in Hainan by vessels, and a limited amount by roadways. We are currently constructing a new terminal for liquid hazardous chemicals with one 10,000 dwt berth and one 5,000 dwt berth at our Hainan production complex for the transportation of methanol to be produced at our new CNOOC Jiantao Methanol Plant. The construction commenced in 2005 and is scheduled for completion in September 2006. Upon completion, a methanol pipeline will transport liquid methanol from CNOOC Jiantao Methanol Plant to the new terminal for loading into chemical tankers. Our total capital investment in the new liquid hazardous chemical terminal is expected to be approximately RMB298.0 million. As of 31 March 2006, we incurred capital expenditure for the construction of the terminal of RMB50.4 million.

Transportation of Products Produced in Inner Mongolia

We deliver the traditional prill urea products produced at Tianye Plant to our customers in Inner Mongolia and northern and northeastern China via the railroad and roadway systems. Because of the lack of accessible waterway systems in Inner Mongolia, we only deliver very limited amounts of urea products to customers by boat. Rail is therefore the most reliable and efficient means of long-haul delivery, as compared to trucks which are limited to short-haul transportation. In 2005, approximately 82.3% and 17.7% of the urea products sold by Tianye Chemical were transported via railroad and roadways, respectively.

We deliver the liquid methanol produced at Tianye Plant solely by railroad and roadways. Upon commencement of its trial production of methanol on 11 December 2005, Tianye Chemical purchased 150 hazardous chemical tanker cars exclusively for the shipment of methanol.

COMPETITION

The fertilizer industry in China is highly competitive. Our urea products compete on the basis of product quality, consistency, product development, customer service, distribution capabilities and price. Due to capital intensity, environmental sensitivity and constraints on natural gas supplies in the nitrogenous fertilizer industry, there are significant entry barriers to large-scale operations. Consequently, the nitrogenous fertilizer industry in China, particularly the urea and ammonia production industries, is highly fragmented.

While our production complexes in Hainan are located along the coast, our Tianye Plant in Inner Mongolia is located inland. Due to the transportation costs involved in transporting urea over long distances, the markets in which products from our production complexes in Hainan compete are to a certain extent distinct from the market in which products from our Tianye Plant compete.

Hainan Operation

As of 31 December 2005, although there were a large number of urea manufacturers in China, only a limited number, including us, had an aggregated designed annual production capacity of 750,000 tonnes of ammonia and 1,300,000 tonnes of urea or more. See “Industry Overview”.

We view as our principal competitors a number of large-scale nitrogenous fertilizer producers located in southern and eastern China, such as Sichuan Lutianhua Co., Ltd., Hubei Yihua Chemical

Co., Ltd., and Guangxi Hechi Chemical Co., Ltd. Certain of our competitors from these regions have substantial production capacities and enjoy steady supply of raw materials, such as natural gas, residual oil and coal, at more competitive prices. However, some competitors from these regions also face significantly higher transportation costs when they transport their coal-based products to their customers via railroad or roadways rather than waterways and sea. In addition to large-scale producers located in southern and eastern China, we also compete to a certain extent with mid- and small-scale urea producers located in close proximity to their respective customers.

With China's accession to the WTO, the PRC Government has undertaken to open up the domestic market to foreign companies. We expect that competition from foreign fertilizer manufacturers will increase. Such foreign competitors may have competitive advantages over our Company in terms of access to abundant financial resources, brand recognition, international distribution networks and management know-how. Intensified competition from these foreign competitors may lead to lower profit margins for our business due to price competition, loss of customers and reduction in our sales. See "Risks Factors—Risks relating to the fertilizer and chemical industries in China—We face significant challenges and changes in government policies, including changes to VAT policies, adjustments of export custom duties and accession to the WTO, which could affect the operation environment of our industry and thus our financial performance".

Inner Mongolia Operation

The principal competitors of our operation in Inner Mongolia for the traditional prill urea products are domestic traditional prill urea manufacturers located in Inner Mongolia and northern China who primarily supply nitrogenous fertilizers to wholesale customers for resale such as Tianji Coal Chemical Industry Group Co., Ltd. (天脊煤化工集團有限公司), Zhong Yuan Dahua Group Ltd. of Henan Province (河南省中原大化集團有限公司) and Liaoning Huajin Tonghua Chemical Industry Co., Ltd. (遼寧華錦通達化工股份有限公司). We compete on the basis of the price and quality of our products, production capacity, delivery performance and customer service.

We also compete with methanol producers located in northern China and southeastern China with respect to sales of our methanol products produced at Tianye Plant. Some of our domestic competitors are situated in close proximity to the coastal regions of China, and therefore enjoy more convenient transportation infrastructure for delivery of their products than we do. As a result, these competitors may have lower transportation expenses than we do. We also face competition from overseas fertilizer and methanol manufacturers who supply the Chinese market. However, we believe that our key advantage over foreign competitors is our close proximity to our customers, which allows us to provide prompt delivery at lower delivery costs.

QUALITY CONTROL

We implement stringent quality control measures throughout our production process in accordance with national standards. Each of our plants, including CNOOC Jiantao Methanol Plant, has its own quality control department to ensure product quality meets the standards set by the PRC Government. Fudao Phase I and Fudao Phase II are accredited with ISO9001 certification.

The quality management and control system of our production facilities encompasses the following features:

- *Process control*—well-trained management and operating personnel to optimize operations, stabilize production and ensure product quality.
- *Packaging and storage*—systematic package and storage procedures are in place to ensure proper packaging and to avoid any damage to the products during storage in our warehouses.
- *Testing and Inspection*—testing appliances are installed in each production workshop. Quality inspection teams undertake random tests of both intermediate and finished products on a sample basis to ensure the products comply with the required standards. Testing processes include checking physical appearance and composition of nutrients.
- *Machinery and equipment management*—engineers and other personnel conduct regular checks, repairs and maintenance of our production facilities to ensure stable, safe and reliable operation of the production facilities.

As of the Latest Practicable Date, we had not experienced any material sales returns by customers and had not experienced any product liability or other legal claims due to allegations relating to, or problems with, the quality of our products.

RESEARCH AND DEVELOPMENT

The focus of our research and development activities will be on new product feasibility assessment, production process and technology improvement and cost efficiency. We believe that our research and development efforts facilitate our ability to introduce technologically advanced new products and improve our production processes. We plan to invest in research and development through in-house research and development activities, joint development with reputable third-party research and development institutes, and strong incentives to employees.

Although we incurred an insignificant amount of expenditure on product assessment in 2003, we expended RMB0.8 million, RMB1.4 million and RMB0.8 million on feasibility studies and safety and environmental protection assessment for polyoxymethylene and other chemicals for the two years ended 31 December 2004 and 2005 and the three months ended 31 March 2006, respectively.

ENVIRONMENTAL MATTERS

Production

According to PRC environmental laws and regulations, fertilizer producers in China must comply with environmental laws and regulations stipulated by the State and the local environmental protection agencies. Companies are required to carry out environmental impact studies before the commencement of construction to ensure that production processes meet the required PRC environmental standards. Our operations are therefore subject to numerous national and provincial environmental laws and regulations governing the discharge of wastewater, gas emissions, hazardous chemicals and waste management. We are committed to environmental protection. We abide by all relevant environmental laws and regulations and our Hainan production facilities obtained ISO14001 certification from China Certification Group Limited for Quality Mark (方圓標誌認證集團有限公司) for our environmental management standards.

We conduct environmental feasibility studies for all of our new production, expansion or reconstruction projects. New production, expansion or reconstruction projects must include facilities for the prevention and control of pollution and treatment of waste materials. Before the new facilities may be put into operation, the pollution control and waste processing facilities are inspected by the environmental protection department and must be commissioned simultaneously with the new facilities. Our Fudao Phase I production facilities received the Model Enterprise of Clean Productions award from the Hainan Provincial Government in 2002. In order to ensure compliance with the relevant laws and regulations on environmental protection, Tianye Chemical has implemented measures to monitor wastewater, exhaust gas and solid waste. All such waste is treated before being discharged in accordance with the relevant environmental laws and regulations. The management of Tianye Chemical has confirmed that the production facilities meet the applicable PRC standards relating to environmental protection. Tianye Chemical also conducts environmental feasibility studies for all of its new production, expansion or reconstruction projects. New production, expansion or reconstruction projects must include facilities for the prevention and control of pollution and waste materials. Before the new facilities may be put to use, the pollution control and waste processing facilities must be inspected by the environmental protection department and be commissioned simultaneously with the new facilities.

Pollution Control

We believe that our environmental protection systems and facilities meet national waste management standards and comply with applicable national and provincial environmental protection laws and regulations governing wastewater treatment and gas emissions. Our Hainan production facilities utilize technologically advanced production facilities imported from leading chemical equipment manufacturers which have enhanced our ability to ensure we comply with national standards for wastewater, dust and gaseous pollution. Control measures at Tianye Plant for wastewater, exhaust gas, solid waste, furnace smoke, odor, surface and underground water and noise pollution comply with national standards.

Based on the official letters issued by the relevant environmental protection authorities, our PRC legal advisor advised us that we complied with all applicable laws and regulations regarding pollution control during the Track Record Period in all material respects.

Inspections

The Hainan provincial government, through its Department of Land, Resources and Environment (海南省國土環境資源廳), conducts random inspections at our production site in Hainan. The Dongfang City Bureau of Land, Resources and Environment (東方市國土環境資源局) conducts periodical inspections at our production site. We regularly inspect our wastewater treatment systems and gas emissions for compliance with applicable requirements. At Tianye Plant, regular inspections are conducted by the Inner Mongolia Environment and Resources Administration (內蒙古環境資源廳) and the Huhhot City Environment and Resources Bureau (呼和浩特環境資源局).

We believe that we are currently in compliance with all material national and provincial environmental laws and regulations applicable to us. As of 31 March 2006, we were not subject to any material environmental claims, lawsuits, penalties or disciplinary actions. However, in 1997 and prior to CNOOC Chemical's acquisition of the predecessor of CNOOC Fudao, rainwater caused a large amount of urea stored outdoors to dissolve and seep into neighboring farmland. The high concentration

of urea polluted the soil. The accident was not covered by any insurance. We reached a settlement with the local residents pursuant to which we have made payments to the local residents every year since the occurrence of the pollution as compensation for damages caused to the local community. We will continue to make such payments until the damage is mitigated over time. CNOOC has agreed to indemnify us against our direct economic losses arising from such compensation payable by us to the local residents. See "Connected Transactions—Indemnity Agreement". As of 31 March 2006, we had paid an aggregate amount of approximately RMB5.5 million in damages. We currently have insurance which we believe will cover similar accidents should they occur in the future. See "—Insurance". In August 2005, several local residents in the town neighboring our Hainan facilities complained of the smell of ammonia emitted from our chimneys; however, our operations were not materially interrupted or affected by such complaint. Nevertheless, in cooperation with SNAMPROGETTI, one of our equipment facility providers, we are currently in the process of planning the design for raising the height of our chimneys to enable better dissipation of our gaseous emissions. We currently do not have an expected completion date or an estimate of the funds required for this project.

OCCUPATIONAL HEALTH AND SAFETY

Our Chemical Products and Materials

Our business operations involve the use and production of chemicals that are potentially dangerous, including natural gas, urea, methanol and ammonia. These chemicals could result in damage to, or destruction of, properties or production facilities, personal injury, environmental damage, business interruption and possible legal liability. The primary raw material used in our production processes is natural gas, which is highly explosive and combustible, flammable, and poisonous. Urea, one of our main products, may cause irritation to the skin and eyes upon contact. Methanol, our other main product, is highly poisonous and may result in blindness, metabolic acidosis, or damage to the central nervous system and liver if ingested or inhaled. Ammonia, a product of natural gas used for urea manufacture, may cause irritation and caustic burns if ingested or severe eye damage upon contact. See "Risk Factors—Risks relating to our business operations—Methanol and the fertilizer components and products that we manufacture, process, store, handle, distribute and transport are very volatile and may be harmful if handled or disposed of improperly. Natural gas, our primary raw material, is also highly combustible. Accidents involving these substances, which are often subject to high pressures and temperatures during the production process, could cause severe damage or injury to property, the environment and human health."

Safety Measures

We regard occupational health and safety as one of our important social responsibilities and have implemented safety measures at our production facilities to ensure compliance with applicable regulatory requirements. We conduct periodic inspections of our production facilities in Hainan to ensure that our production operations comply with existing laws and regulations. We also conduct regular training sessions for employees on accident prevention and management. We have obtained a Safety in Production Permit for Fudao Phase I and Fudao Phase II. We have not experienced any major accidents or injuries in our production during the Track Record Period. We maintain separate production safety measures for Tianye Plant. We obtained a Safety in Production Permit for Tianye Plant in March 2005. We follow governmental regulations in adopting our own safety rules to be followed by all employees at Tianye Plant. We also provide safety-related education to employees. At individual facilities, safety measures and regular safety inspection points are imposed at all stages of

the production process to minimize the possibility of work-related accidents or injuries. We maintain personal injury and medical insurance coverage which covers all of our employees at both our Hainan facilities and Tianye Plant. Our PRC legal advisor confirmed that we have not been subjected to any administrative punishment due to violation of the safety regulations and laws during the Track Record Period.

Fire Prevention

Our production facilities in Hainan and Inner Mongolia are equipped with automatic fire alarm systems and inflammable gas detectors. In addition, Fudao Phase II has its own firefighting management network. Our own fire brigade based at our Hainan production facilities, consisting of 28 full-time firefighters as of the Latest Practicable Date, is responsible for handling fires and other threats to safety within our Hainan production facilities and other properties in Hainan. We currently own four fire-fighting vehicles, including one water truck, one chemical foam truck, and two dry powder trucks for use at our Hainan production facilities. Fire drills are conducted in accordance with applicable requirements, and fire-fighting equipment inspections are carried out according to schedule. At Tianye Plant as of the Latest Practicable Date, we had 33 full-time firefighters and three fire-fighting vehicles.

Based on the certificates issued by the relevant fire prevention authorities, our PRC legal advisor advised us that we complied with the fire prevention regulations during the Track Record Period in all material respects.

INTELLECTUAL PROPERTIES

The predecessor of CNOOC Fudao owns a patent registered in China as of the Latest Practicable Date, which is related to the anti-agglomerate chemical technology applied in all of our granular urea products. Upon completion of the registration of CNOOC Fudao as the owner of the patent, we would be able to enjoy all rights and benefits in that patent.

We use a number of trademarks, trade names and service marks in connection with our business, namely, "富岛", "CNOOC", "天野" and "天TY野" which we have registered as trade marks or licensed from our Parent Company. See "Appendix VIII—Statutory and General Information".

We have non-exclusive licenses to the technologies used at our production facilities. For Fudao Phase I, we imported the ammonia synthesis facility utilizing ICI-AMV ammonia synthesis technology from Japanese general contractors Chiyoda Corporation and Nissho Iwai Corporation, as well as the ammonia stripping facility utilizing SNAMPROGETTI technology from Italy. We paid a once-off fee of approximately U.S.$5.0 million to license the technology. For Fudao Phase II, we license the ammonia synthesis facility and its underlying technology from KBR, a U.S. chemical production facilities general contractor and technology provider, as well as the patented CO_2 stripping technology and pool condensers from Stamicarbon S.A., a supplier of urea production technology. We paid a once-off fee of approximately U.S.$8.9 million to license the technology. For both Fudao Phase I and Fudao Phase II, we license the granulating facility and the underlying fluid-bed granulating technology from Norsk Hydro, a Norwegian company. For CNOOC Jiantao Methanol Plant, we license the advanced methanol technologies and facilities from Germany's Lurgi Group. We paid a once-off fee of approximately U.S.$1.2 million to license the technology. There were no legal disputes in respect of these licenses during the Track Record Period.

In addition, Tianye Chemical licenses technology for its production facilities. For the integrated ammonia and urea facilities, Tianye Chemical imported the ammonia synthesis facility utilizing Kellogg ammonia synthesis technology from Japanese general contractors Toyo and Mitsui Sumitomo, as well as the ammonia stripping facility utilizing SNAMPROGETTI technology from Italy. Tianye Chemical also licenses technologies for the production of methanol from domestic methanol equipment producer and technology provider Hangzhou Linda Chemical Technology Engineering Corporation. There were no legal disputes in respect of these licenses during the Track Record Period.

REAL PROPERTIES

As of 30 June 2006, we used or owned (i) the land use rights to 58 parcels of land with an aggregate site area of 4,607,384.2 m^2 (of which 294,886.8 m^2 are used for residential purposes rather than for our core business operations); (ii) buildings with an aggregate gross floor area of 390,111.5 m^2 (of which 115,684 m^2 is used for residential purposes and not for our core business operations); and (iii) buildings under construction with an aggregate gross floor area of 8,241.64 m^2 upon completion. We occupied such land and buildings for use in all aspects of our production and businesses.

Land

The land use rights to land either owned or used by us comprised:

- 11 parcels of granted land for which we obtained granted land use rights certificates;
- 23 parcels of granted land the title certificates of which were held by our subsidiaries prior to the Restructuring; and
- 23 parcels of land which were granted by way of capital injection and whose land title certificates were held by our subsidiaries prior to the Restructuring; and
- 1 parcel of land to which we have not obtained the relevant land use rights certificate but have signed a land grant contract and are in the course of applying for the land use rights certificate.

Buildings

- The buildings with an aggregate gross floor area of 118,980.2 m^2 for which we have building ownership certificates and the buildings with an aggregate gross floor area of 1,549.2 m^2 for which we do not have proper building ownership certificates;
- The buildings with an aggregate gross floor area of approximately 257,924.2 m^2, the building ownership certificates of which were held by our subsidiaries prior to the Restructuring and the buildings with an aggregate gross floor area of approximately 11,658 m^2 for which the relevant subsidiaries do not have proper building ownership certificates (of which 1,120 m^2 is used for residential purposes and not for our core business operations).

Buildings under construction

- The buildings with an aggregate gross floor area of 8,241.6 m^2 upon completion are currently under construction.

Leased property

We also leased from the CNOOC Group certain buildings with a total gross floor area of 2,704 m^2 pursuant to the Properties Leasing Agreement described in the section headed "Connected Transactions". We also leased from an independent third party an office unit with a gross floor area of 96.4 m^2.

Sallmanns (Far East) Limited, an independent valuer, valued our property interests at RMB1,616.6 million as of 30 June 2006. The text of the letters, valuation summary and valuation certificates issued by Sallmanns (Far East) Limited in connection with its valuations are set out in Appendix IV to this Prospectus.

INSURANCE

Our significant insurance policies for ongoing operations principally include all risks and machinery breakdown. We carry third party liability insurance for personal injury or environmental damage arising from accidents at our production facilities and port. Consistent with customary practice in China, we do not carry any business interruption insurance or product liability insurance relating to claims or liabilities that may arise from any defects of our products. Most of our operation-related insurance policies are subject to deductibles and annual renewal. We believe that our insurance coverage is in line with industry practice in China. See "Risk Factors—Risks relating to our business operations—Our operations are subject to operating hazards and natural disasters that may not be fully covered by our insurance policies" and "Risk Factors—Risks relating to our business operations—We do not carry product liability insurance for the use of our products or business interruption insurance."

We also have insurance policies for projects under construction principally covering all risks, third party liabilities and equipment in transit from overseas insurance against risk of loss. Contractors are responsible for portions of the insurance premium for projects under construction.

LEGAL PROCEEDINGS

In December 2004, Tianye Chemical entered into an agreement with Aukang Petrochemical Equipment Mfg. Co., Ltd. (湖北省洪湖市奥康石化設備製造有限公司) ("Aukang") pursuant to which Tianye Chemical agreed to purchase aluminum ammonium materials from Aukang, the seller. The contract price was RMB4.7 million. When Tianye Chemical paid RMB2.8 million, however, Aukang refused to deliver the goods. Instead, Aukang raised the contract price by another RMB1.8 million, and threatened to cancel the contract unless Tianye Chemical paid this additional amount. After unsuccessful negotiations, Tianye Chemical filed a claim against Aukang in the Intermediate People's Court of Huhhot, requesting (i) rescission of the contract, (ii) recovery of the amount already paid by Tianye Chemical, (iii) damages for breach of contract in the amount of RMB0.9 million, and (iv) the payment of litigation costs. Aukang subsequently filed a separate claim against Tianye Chemical in the people's court of Honghu City in Hubei Province for breach of contract, requesting (i) an increase of RMB1.8 million to the contract price, (ii) payment of RMB1.9 million as consideration for processed products, and (iii) payment of litigation costs.

As of the Latest Practicable Date, the disputes were pending the decision of the Supreme People's Court as to the proper jurisdiction to handle the disputes. We believe that the results of these proceedings will not adversely affect our or Tianye Chemical's operations or financial condition.

Except for the foregoing proceedings, as of the Latest Practicable Date, neither we nor any of our subsidiaries were involved in any litigation, arbitration or administrative proceedings that could have a material adverse effect on our financial condition, or results of operations, taken as a whole. So far as we are aware, as of the Latest Practicable Date, no such material litigation, arbitration or administrative proceedings are threatened.