



MARKET REVIEW

In 2006, the flat glass industry of China remained in its cyclical trough and began to recover in the second half of 2006. This was mainly attributable to the surge in production capacity, which led to an oversupply in the market. Worse still, keen competition among glass manufacturers scattered around the country also contributed to the prolonged low selling prices. Meanwhile, prompted by the ongoing price hike in global crude oil, heavy oil prices had surged in 2006. Owing to the increase in production costs and the imbalance between supply and demand of glass products, prices had remained low and profits had dropped remarkably, causing the glass industry to suffer on the whole. Under the dual pressure from the fall in selling prices and rise in energy costs, the glass industry of China incurred a net loss of RMB1 billion in October 2006.

Glass manufacturers were reluctant to make new investments because of the decline in profits and shortage of funds. However, since there were a number of projects in progress in 2005, production capacity did increase in 2006. During the year, a total of 19 production lines were built and put into operation, representing an additional production capacity of 54.02 million weight cases. According to the statistics of the China Architectural and Industrial Glass Association, the total output of the flat glass industry in China was 440 million weight cases from January to November, 2006, representing an increase of approximately 7% and an obvious slowdown in capacity growth as compared with the same period last year. In the second half of 2006, industry profits have somewhat rebounded, thanks to a fall in oil prices and lessening of supply/demand imbalance.

BUSINESS REVIEW

The Group currently operates five flat glass production lines upon completion of the acquisitions of Shaanxi Blue Star Glass Co., Ltd. ("Shaanxi Blue Star") and Beijing Qinchang Glass Co., Ltd. ("Beijing Qinchang"). Daily melting capacity has increased from 1,500 tons to 2,250 tons.

During 2006, the Group produced 9.00 million weight cases of flat glass, representing an increase of 43% as compared to last year. The Group recorded a sales volume of 9.05 million weight cases, a rise of 49%. Sales/production ratio during the year was 101%, representing an increase of 4% as compared to last year. During 2006, domestic sales volume accounted for 66% of the total sales volume, representing a year-to-year decrease of 1%. Export volume accounted for 34% of the total sales volume in 2006, representing a year-to-year increase of 1%.

Confronted with the surge in energy prices and oversupply in the market resulting from the surge in production capacity, the Group recorded a decline of 9% in net profit during the year. The plight in 2005 prolonged to the first half of 2006, followed by a recovery in the second half of 2006 and a rise in gross profit mainly attributable to the rebound of selling prices and the fall of heavy oil prices. Meanwhile, the decline in our production costs also contributed to the earnings of the Group, thanks to the acquisition of Shaanxi Blue Star which operates its production lines on cheaper coal-fired rather than oil-fired basis.



In order to satisfy the market demand on quality glass and product mix, and to enhance the Group's competitive strength in the market for a higher return in the future, China Glass has been expanding its product mix through the establishment of new production lines and mergers & acquisitions. In 2006, the Group set up its second float glass production line in Shaanxi and a production line for ultra clear glass for solar cell in Taicang, Jiangsu jointly with Pilkington International Holdings BV. As for mergers and acquisitions, the Group succeeded in acquiring Shaanxi Blue Star and Beijing Qinchang in 2006. In late 2006, the Company obtained approval from the Shareholders' General Meeting for the acquisitions of Weihai Blue Star, Zhongbo Technology and Hangzhou Blue Star and the additional investment in Shaanxi Blue Star. China Glass will expand its product mix to include coated glass, rolled glass and more value-added glass products such as low-e glass and ultra clear glass from its current categories of clear glass and tinted glass. As announced by the Company, the acquisitions of the four transactions mentioned above were completed on or before 9 March 2007.

OUTLOOK

Since the development of the glass industry is closely related to a number of industries in the domestic economy, the demand for glass keeps pace with the future economic development of the PRC. Despite the fact that the glass industry remained in its cyclical trough in 2006 and began to recover in the fourth quarter of 2006, the sales/production ratio of the flat glass market remained at 97%, representing an increase of 4% as compared to that of last year. The flat glass market is expected to maintain a steady growth.

Under the coordination of the National Development and Reform Commission, the paper titled "Certain Opinions Regarding the Structural Adjustment of Flat Glass Industry" was officially published by six ministries and commissions. As a major guideline for the development of the flat glass industry during the period of Eleventh Five-Year Plan, this document will play a positive and pivotal role in the industry. The "Certain Opinions Regarding the Structural Adjustment of Flat Glass Industry", which emphasizes the importance of structural adjustment and energy conservation for the glass industry today, provides an objective analysis of the necessity and urgency of speeding up the structural adjustment for the industry. While further clarifying the guiding thoughts and objectives of the structural adjustment, the opinions outline the related policies for such an adjustment and bring new hopes to the healthy development of the industry. The current competition is expected to undergo a new change and the glass industry is expected to enter into a new phase of development and adjustment.

According to the outline of the Eleventh Five-Year Plan for National Economic and Social Development, the GDP growth rate of the PRC will remain at above 8% before 2010. The coming five years will be the period for the industrialization and urbanization of the country and the period for the rapid growth of rural areas. These five years will also be a good chance for the glass industry to capitalize on every development opportunity. Emerging industries such as the construction, transportation, information technology and solar energy industries will become the pillar for the sustained development of the PRC economy, and will facilitate the development of glass industry to a larger extent. The massive use of energy-saving glass and the ongoing improvement in related policies have both enhanced the development of the glass industry. Thanks to the promising export volume in recent years, flat glass exports recorded an average growth rate of 32% during the period of the Tenth Five-Year Plan. According to analyses on the global economic development and the international competition environment, glass exports will remain favorable in the Eleventh Five-Year period. With the rapid development of domestic economy and relevant industries, it can be anticipated that people's living standard in the PRC will be improved and export volume will be increased. In the years to come, there will be a robust market demand and promising development prospect for the PRC glass industry.



A paper was issued by the six ministries and commissions on “categorizing and strictly controlling new projects”, which will be implemented as the next step towards the promotion of structural adjustment of the glass industry. According to the paper relating to these measures, new float glass projects are required to be “approved” by the provincial investment authority and “confirmed” by authorities such as the National Development and Reform Commission and the China Architectural and Industrial Glass Association. All projects in progress and proposed projects in 2006 have been put under strict control by the industrial policy and the approval standards of the industry. Under such measures, it is hoped that irrational expansion will be rectified and growth in production capacity will be slackened, thus improving the supply and demand balance and creating a fundamental change to the competition environment of the glass industry.

The industrial policies and regulations of the PRC also have a sound effect on the glass market. The implementation of such policies and regulations as the “Mid-Term and Long-Term Specific Plan for Energy Conservation” and the “Energy Conservation Engineering in Government Organizations” is set to provide enormous business opportunities for the glass processing markets of insulating glass, low-e insulating glass and solar energy glass which are characterized by their energy conservation and environmental protection features. New construction projects under the “energy conservation goals” and the requirements of the “Opinions Regarding the 10 Key Energy Conservation Engineering of the ‘Eleventh Five-Year Plan’” will have to reach the goal of 50% in energy conservation, while those in the northern and chilly parts of China and the four municipalities will have to reach 65%. This will help promote the utilization of energy conservation glass products such as insulating glass and low-e insulating glass so as to meet energy saving requirements in construction projects. Meanwhile, the extensive development and utilization of solar energy will also enhance the demand for solar energy glass products.

To regulate market competition fundamentally and improve the economic benefits of the industry, mergers, acquisitions, reorganizations and affiliations have become inevitable trends of development. The present situation of much-too-scattered enterprises results in not only poor economic benefits and high costs, but also disordered competition in the market and created chaos in export prices which induces “anti-dumping” measures imposed by overseas countries. Now that market demand is slowing down, it is a prime opportunity to combine and reorganize enterprises for structural adjustment. The paper issued by the six ministries and commissions stipulates that the authorities concerned will formulate specific policies to support the development of large groups in order to form a huge syndicate composed of 10 competitive enterprises within the period of Eleventh Five-Year Plan, so as to strengthen the adjustment capabilities of the syndicate in regional markets.

Under state planning, the structure of the glass industry as well as the application of glass products will certainly create promising opportunities for the Group. Through the organic growth and mergers & acquisitions, the Group has already become the largest flat glass listed companies in the PRC in terms of total melting capacity. The Group’s product mix, export network and technological research and development capabilities are set to grow. We have full confidence in the future development of the Group.



FINANCIAL REVIEW

Turnover

The Group's turnover increased by approximately 48% from RMB386.49 million for the year ended 31 December 2005 to RMB573.14 million for the year ended 31 December 2006, which was mainly attributable to the increase in sales volume resulting from the completion of acquisitions of Shaanxi Blue Star and Beijing Qinchang in 2006 and the full year production of the third production line.

Cost of sales

The Group's cost of sales increased by approximately 59% from RMB324.92 million for the year ended 31 December 2005 to RMB517.83 million for the year ended 31 December 2006. This was mainly attributable to the increase in sales volume and the acquisitions of Shaanxi Blue Star and Beijing Qinchang and the increase in cost per weight case as a result of the increase in costs of fuel due to the increase in global crude oil price.

Gross profit

The Group's gross profit dropped by approximately 10% from RMB61.58 million for the year ended 31 December 2005 to RMB55.31 million for the year ended 31 December 2006. This was mainly attributable to declines in the price of glass and the increase in the costs of fuel and raw materials. Gross profit margin dropped from 16% in 2005 to 10% in 2006.

Distribution costs

The Group's distribution costs increased by approximately 47% from RMB16.38 million for the year ended 31 December 2005 to RMB24.10 million for the year ended 31 December 2006, which was mainly attributable to the increase in the cost of exports due to the increase in export sales.

Administrative expenses

The Group's administrative expenses increased by approximately 44% from RMB23.29 million for the year ended 31 December 2005 to RMB33.54 million for the year ended 31 December 2006, which was mainly attributable to the acquisitions of Shaanxi Blue Star and Beijing Qinchang.



Finance costs

The Group's finance costs increased by approximately 101% from RMB7.74 million for the year ended 31 December 2005 to RMB15.54 million for the year ended 31 December 2006, which was mainly attributable to the increase of bank and other loans resulting from the acquisitions of Shaanxi Blue Star and Beijing Qinchang and increase in convertible notes.

Income tax

The Group's income tax dropped by approximately 614% from RMB0.83 million for the year ended 31 December 2005 to RMB(4.26) million for the year ended 31 December 2006, which was mainly attributable to the tax benefit enjoyed by the Mainland subsidiaries of the Group. Subject to the regulations of Foreign Investment Enterprise and Foreign Enterprise Income Tax of the PRC, the subsidiaries of the Group, being production-oriented foreign enterprises with an operation period for more than 10 years, are entitled to exemptions from Enterprise Income Tax in the first and second years and 50 percent reductions of Enterprise Income Tax in the subsequent three years, commencing with the first profit-making tax year.

Non-current assets

The Group's non-current assets increased by approximately 74% from RMB567.13 million as at 31 December 2005 to RMB987.87million as at 31 December 2006, which was mainly attributable to the acquisitions of Shaanxi Blue Star and Beijing Qinchang.

Current assets

The Group's current assets increased by approximately 89% from RMB197.14 million as at 31 December 2005 to RMB373.36 million as at 31 December 2006, which was mainly attributable to the acquisitions of Shaanxi Blue Star and Beijing Qinchang.

Current liabilities

The Group's current liabilities increased by approximately 90% from RMB315.16 million as at 31 December 2005 to RMB597.85 million as at 31 December 2006, which was mainly attributable to the acquisitions of Shaanxi Blue Star and Beijing Qinchang.

Non-current liabilities

The Group's non-current liabilities increased by approximately 371% from RMB51.05 million as at 31 December 2005 to RMB240.66 million as at 31 December 2006, which was mainly attributable to the acquisitions of Shaanxi Blue Star and Beijing Qinchang.



Capital structure, liquidity, financial resources and assets-liabilities ratio

As at 31 December 2006, the Group's cash and cash equivalents were RMB67.28 million, of which 60% were denominated in RMB, 27% in United State dollars ("USD") and 13% in Hong Kong dollars ("HKD") (2005: RMB113.59 million), and the outstanding bank and other loans were RMB421.10 million, all of which were denominated in RMB (2005: RMB150.00 million). As at 31 December 2006, the gearing ratio (total interest-bearing debts divided by total assets) was 37% (2005: 27%), the increase of which was primarily attributable to the increase in bank and other loans and convertible notes. As at 31 December 2006, the Group's current ratio (current assets divided by current liabilities) was 0.62 (2005: 0.63), the fall of which was mainly attributable to the increase in bank and other loans. In addition, the Group recorded net current liabilities amounting to HKD224.49 million as at 31 December 2006. The Company may consider issue of debt and equity to improve the financial position with this regard. Assets-liabilities ratio (total liabilities divided by total assets) of the Group was 0.62 (2005: 0.48), the rise of which was primarily attributable to the increase in bank and other loans and convertible notes.

Details of the bank and other loans are set out in Note 21 to the financial statements.

Material investments, acquisitions and disposals

During 2006, the Company has completed the very substantial acquisitions of Shaanxi Blue Star and Beijing Qinchang. At the special general meeting held on 18 December, 2006, the resolution to acquire Weihai Blue Star, Zhongbo Technology, Hangzhou Blue Star and the additional investment in Shaanxi Blue Star by the Group was passed by the shareholders and these four transactions were also completed on or before 9 March 2006.

On 5 October 2006, the Group announced to form a joint venture in Taicang, Jiangsu Province in the PRC, to engage principally in the production of low iron glass for solar cell.

On 10 October 2006, the Group announced to set up a float and coated glass production line in Xianyang, Shaanxi Province.

Other than disclosed above, the Group did not have any material investments or capital assets, or material acquisitions and disposals of subsidiaries and affiliated companies during the year ended 31 December 2006.

Human resources and employees' remuneration

As at 31 December 2006, the Group had employed a total of approximately 2,610 employees in the PRC and Hong Kong (31 December 2005: about 1,380 employees). According to the relevant market situation, the Group's employees' remuneration level had maintained at a competitive level and is adjusted in accordance with the employees' performance.

The employees of the companies in the Group which were established in the PRC and in Hong Kong participate in defined contribution retirement benefit schemes and Mandatory Provident Fund Scheme, respectively. No contributions to the above schemes were forfeited for the year ended 31 December 2006. Details of staff costs and pension schemes were set out in Note 5(b) to the financial statements.



Charge on assets

As at 31 December 2006, the Group had not charged any of its assets.

Capital commitments

Details of the Group's capital commitments as at 31 December 2006 were set out in Note 29(a) to the financial statements.

Contingent liabilities

As at 31 December 2006, the Group did not have any significant contingent liabilities.

Exchange rate risk and related hedging

The Group's sales transactions and monetary assets were primarily denominated in HKD, RMB, USD and EUR. Operating expenses and domestic sales of the Group's PRC subsidiaries were primarily denominated in RMB, except that overseas sales income was in USD and EUR. The Group was of the opinion that the future appreciation of RMB will closely associate with the development of the PRC economy. With the sustainable development of the PRC economy, the Group expects that RMB will continue to appreciate. Our net assets, profits and dividends may be affected by the fluctuation of the RMB exchange rate.

During the year ended 31 December 2006, the Group had not adopted any derivatives for hedging purposes.

Major customers and suppliers

The percentage of purchases and sales for the year ended 31 December 2006 attributable to the Group's major suppliers and customers are as follows:

Purchases

- the largest supplier	23%
- five largest suppliers combined	46%

Sales

- the largest customer	5%
- five largest customers combined	20%

During the year ended 31 December 2006, no director of the Company ("Director(s)") or any associates of a Director or any shareholder (which to the knowledge of the Directors owns more than 5% of the Company's share capital) of the Company has any interest in any of the Group's five largest customers and suppliers.