

# MANAGEMENT DISCUSSION AND ANALYSIS

## Industry review

In 2006, with the PRC Government continuous stressing on the “three agricultural issues” (agriculture, rural areas and farmers) and its policies on grain and fertilizer subsidization to encourage farmers, the demand of mineral fertilizer within the agricultural industry recorded sustainable increase. In line with the market changes, from 1 January, the average ex-factory price of urea products set by the National Development and Reform Commission to all large-scale producer with a production capacity of ammonia for a single facility of over 150,000 tonnes was RMB1,500 per tonne and subject to a maximum of a 15% upward price adjustment, a 5% increment from that of 2005. In order to balance the interests between farmers and urea producer, the VAT exemption policy applied to mineral fertilizer manufacturers remained since 1 July 2005. On the other hand, the Government continued to applied seasonal export tariffs to ensure adequate domestic supply and to stable market price, a 30% seasonal export tax rate was in place from 1 January 2006 to 30 September 2006, while the seasonal export tax rate has been adjusted to 15% starting from 1 October 2006 to 31 December 2006. Since 11 December, According to the terms of China’s WTO Concession Commitment, the PRC Government can selectively impose tariff rate quotas on certain types of fertilizers and allocate these quotas to qualified applicants. The tariff rates currently applicable to the imports within and in excess of the quota are 1% and 50%, respectively. Furthermore, the PRC Government launched low season reserve policy in the mid of October 2006.

In 2006, production and sales of urea continued to increase. According to the National Statistic Bureau of the PRC, total mineral fertilizer production in China was 53.0 million tonnes (nutrient), an increase of 14.0% over 46.5 million tonnes in 2005. Total nitrogenous fertilizer production amounted to 38.7 million tonnes (nutrient), an increase of 13.5% over the 34.1 million tonnes in 2005. Total urea production increased 13.2% to 22.3 million tonnes (nutrient) when compared to the 19.7 million tonnes in 2005. The demand and supply maintained balance.

Urea market price in 2006 fluctuated according to seasonality. The first quarter of 2006 appeared to be the low season for urea with price in the first quarter was significantly lowered compared to the same period in 2005. Since March of 2006, demand and price of urea accelerated following the commencement of spring farm, enterprises that have no fertilizer reserve have to purchase fertilizers in the market which further drive up the price and demand to reach and exceed the same period in 2005. Since July 2006, the natural disasters has accelerated the commencement of the low season for fertilizers consumption, with demand rapidly decreased while production volume grew continuously, together with the increased supply from the winter reserve, urea price substantially dropped by up to RMB200-300/tonne in most of the regions. The traditional low season commenced in September 2006 with only some regions and industries consuming fertilizers. The winter reserve policy that was launched by the PRC Government in mid October 2006 has, however, stabilized the urea price during the traditional low season. Since November 2006, international energy price has rose severely, together with the continuous rose in sea transportation costs, the international selling price of urea and some of the mineral fertilizers increased against the market trend, thus, increased the urea export. In view of the influences, urea price in all regions of China experienced significant increase by the end of November 2006.



## Methanol industry

Methanol is an important and basic organic chemical resource. In 2006, its supply in China was not in line with the rapid consumption growth. The PRC Government imposed 5.5% methanol import tax and implemented "Exemption and Refund" taxation scheme to methanol export in which export enterprise pays only 4% VAT on methanol export.

In 2006, production volume of methanol in China amounted to 7.46 million tonnes, an increase of 39.2% over 2005. Total methanol import decreased by 17.1% to 1.13 million tonnes. Total methanol consumption in the year was 8.40 million tonnes, an increase of 26.0% over 2005. China became the second largest methanol consumption country and was also the nation with the fastest growing rate in methanol production and consumption.

With the increasing price of energy and its insufficient global supply, together with the malfunction of some production facilities, since August 2006, methanol price has experienced rapid increase. FOB US was even surged to USD600/tonne by the end of 2006, while China methanol price also increased from RMB2,500/tonne at the beginning of 2006 to RMB3,500/tonne at the end of 2006, reaching a record high in growth rate for the past 10 years. Nevertheless, with large amount of additional capacity, domestic methanol price began to fall towards the end of 2006



## Business review





## Urea

On 19 January 2006, the Company acquired Tianye Chemical and has increased the annual designed production capacity of urea to 1,840,000 tonnes.

In 2006, the Group insisted on the production stability and persistency of its production facilities. Safe and stable production was achieved through proper administration of safety and environmental protection, quality, production, facilities and technical control as well as enhancement of technological operation and careful maintenance of production facilities. Fudao Phase I achieved a record of 214 days and 121 days of continuous production, breaking the previous record of 212 days of continuous production, while setting the best record ever of “high efficiency, low energy consumption, safety and stability” with total production beyond target. Fudao Phase II and Tianye Chemical both lived up to the operation standard with the greatest possible efforts, achieving a satisfactory performance in production.

Production of various facilities during 2006 is as follows:

Urea facility	2005		2006	
	Output (tonnes)	Utilization rate(%)	Output (tonnes)	Utilization rate(%)
Fudao Phase I	535,881	103.1	<b>606,179</b>	<b>116.6</b>
Fudao Phase II	825,132	103.1	<b>775,146</b>	<b>96.9</b>
Tianye Chemical	-	-	<b>546,133</b>	<b>105.0</b>

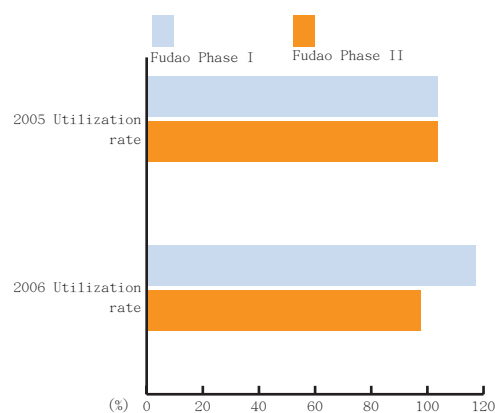
## Methanol

On 19 January 2006, the Company acquired Tianye Chemical resulting in an increase of 200,000 tonnes in the annual designed production capacities of methanol. Methanol facility of Tianye Chemical commenced commercial production on 1 April 2006 with an annual output of 121,502 tonnes in 2006. Because the facilities adjustment period was relatively longer, the utilization rate of Tianye Chemical's methanol was unable to meet the expected targets.

Leveraging on CNOOC's superior experiences in project management, on 12 September 2006, the 600,000-tonne per annum methanol production facility of CNOOC Jiantao succeeded on its trial production in one occasion and 34 days in advance, boosting the annual methanol designed production capacity of the Company to 800,000 tonnes. On 1 December 2006, CNOOC Jiantao's commercial production commenced with the production load exceeding 90% and the quality of products satisfied and exceeded the U.S. Federal “AA” Specifications (O-M-232K) and national standard GB338-2004, sustaining the international advanced standards.

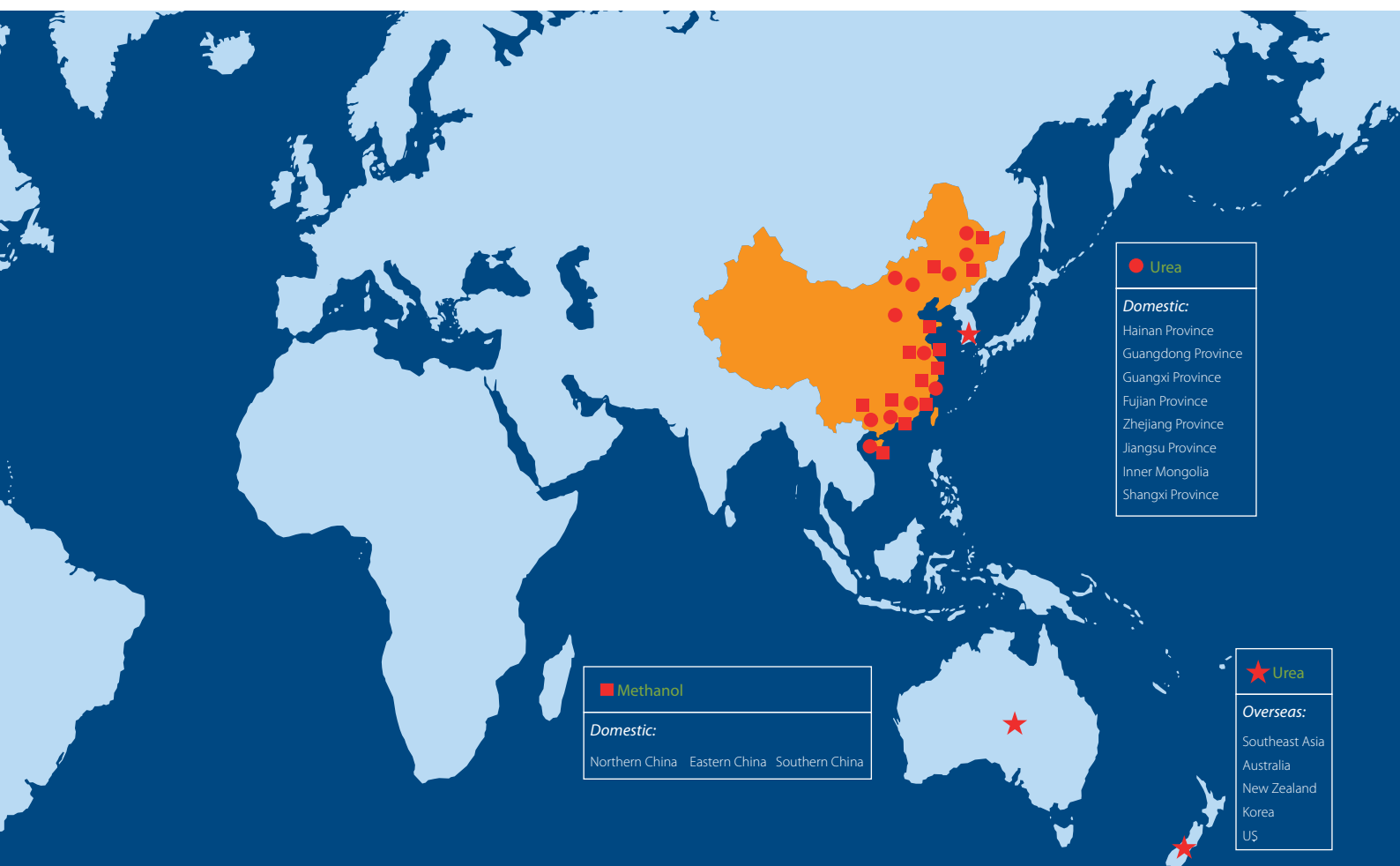
## Sales

To meet seasonal and cyclical fluctuations of the domestic and overseas urea markets, in-depth and detailed market surveys conducted in the Company's two production sales region in Hainan and Inner Mongolia. Profit optimization of product sales was ensured through enhancing information and resource management, integration of sales channels, strengthening of sales network and adopting market-driven pricing strategy.



The following table lists the Company's urea sales breakdown by regions during Track Record Period:

Sales Region	Year ended 31 December					
	2004		2005		2006	
	Quantity (tonnes)	Percentage ( % )	Quantity (tonnes)	Percentage ( % )	Quantity (tonnes)	Percentage ( % )
Northeastern China	-	-	-	-	<b>43,688</b>	<b>2.2</b>
Northern China	154,576	11.2	219,604	16.1	<b>553,969</b>	<b>28.5</b>
Eastern China	176,033	12.8	279,790	20.5	<b>272,716</b>	<b>14.0</b>
Southeastern China	128,379	9.3	151,923	11.1	<b>125,492</b>	<b>6.4</b>
Southern China	226,747	16.4	358,716	26.3	<b>478,483</b>	<b>24.6</b>
Hainan Region	153,028	11.1	176,195	12.9	<b>182,201</b>	<b>9.4</b>
Overseas	541,144	39.2	178,380	13.1	<b>290,712</b>	<b>14.9</b>
<b>Total</b>	<b>1,379,907</b>	<b>100.0</b>	<b>1,364,608</b>	<b>100.0</b>	<b>1,947,261</b>	<b>100.0</b>





### Sea-land logistics services

In 2006, the Port of Basuo has completed a **4,790,000**-tonnes throughput of which 4,080,000 tonnes were for domestic trade and 710,000 tonnes were for export. It also completed land freightage of 1,528,000 tonnes.





### Compound fertilizers

On 8 August 2006, the Group started production of compound fertilizer ("BB fertilizer") suitable for the territories formula. A total of 5,064 tonnes of various types of BB fertilizers were produced during the year, reaching a sales volume of 4,103 tonnes.



### Woven plastic bags

In 2006, the Group produced 28.89 million woven plastic bags. The sales volume was 29.54 million bags in which 26.34 million woven plastic bags were consumed by the Group.



## Financial Review

### Revenue

The Group's revenue in 2006 was RMB3,465.8 million, representing an increase of RMB1,094.8 million from RMB2,371.0 million compared with 2005, or an increase of 46.17%. The increase in revenue of the Group was primarily attributable to (1) the consolidation of Tianye Chemical since 19 January 2006; (2) the commencement of the commercial production of CNOOC Jiantao 600,000-tonne methanol plant in December 2006; and (3) the Group's continuous entitlement to the VAT exemption in 2006.

The consolidation of Tianye Chemical has contributed to an increase of RMB1,009.0 million in the Group's revenue in 2006 and the commencement of the commercial production of the CNOOC Jiantao 600,000-tonne methanol plant in December 2006 has further contributed RMB106.6 million to the Group's revenue for 2006.

Since 1 July 2005, the PRC government has implemented a VAT exemption policy towards the sales of urea products in Mainland China and output VAT otherwise payable has been accounted for as revenue by the Group thereafter. The Group, excluding Tianye Chemical, has recorded an increase of RMB116.4 million in respect of the output VAT otherwise payable as revenue in 2006.

As a result of the foregoing, the Group has overcome the adverse effect of the fall in the domestic selling price of urea caused by the macroeconomic controls over the nitrogenous fertilizer market which has resulted in a decrease in the current year sales of urea of approximately RMB136.5 million.

In 2006, the Group's revenue generated from the sales of urea amounted to RMB2,975.7 million, representing an increase of RMB751.0 million from RMB2,224.7 million of last year, or an increase of 33.76%. The rise was for (1) an increase in revenue of RMB801.2 million contributed by Tianye Chemical which was acquired on 19 January 2006; and (2) an increase in revenue of RMB116.4 million arising from the VAT exemption effect as discussed aforesaid; which was partly offset by the decrease in the current year sales of urea of RMB136.5 million caused by a decrease in the average domestic selling price of urea of RMB100 per tonne in 2006.

In 2006, the Group recorded revenue from the sales of methanol, a new product of the Group, of RMB308.7 million, which was contributed by the 200,000-tonne methanol facility of Tianye Chemical and the 600,000-tonne methanol facility of CNOOC Jiantao. The methanol segment is the Group's new growth driver.

In 2006, revenue from the Group's other segment (mainly comprises of segments engaged in port operation, the provision of transportation services and the manufacture and sales of woven plastic bags) amounted to RMB181.4 million, representing an increase of RMB35.1 million from RMB146.1 million of last year, or

an increase of 23.99%. The main reason for the rise was attributable to the increased revenue generated from the port operation and the provision of transportation services of RMB48.9 million which was offset by the slight decrease in revenue generated from the external sales of woven plastic bags.

### Cost of sales

The Group's cost of sales in 2006 was RMB2,164.2 million, representing an increase of RMB871.1 million from RMB1,293.1 million of last year, or an increase of 67.37%. The main reasons for the rise were (1) a corresponding increase in cost of RMB758.5 million contributed by Tianye Chemical which was acquired on 19 January 2006; (2) the Group, excluding Tianye Chemical, has recorded an increase in cost of sales of RMB37.9 million in 2006 in respect of the input VAT already paid for raw materials under the VAT exemption; (3) the increased cost of RMB27.1 million from the commercial production of the CNOOC Jiantao 600,000-tonne methanol plant; and (4) an additional cost of RMB25.8 million caused by an increase in the urea's sales volume of 29,300 tonnes.

The Group's cost of sale for urea products in 2006 was RMB1,830.6 million, representing an increase of RMB649.9 million from RMB1,180.7 million of last year, or an increase of 55.04%. The main reasons for the increase were (1) an increase of RMB602.3 million from Tianye Chemical; (2) an additional cost of RMB54.4 million by equipment maintenance fees and increased natural gas price; (3) an increase of RMB37.9 million input VAT recorded as cost of sales due to VAT exemption; and (4) an additional cost of RMB25.8 million arising from the increased sale of urea of 29,300 tonnes.

The Group's cost of sale of methanol in 2006 was RMB190.4 million, of which RMB27.1 million was caused by the CNOOC Jiantao 600,000-tonne methanol plant and RMB163.3 million by the 200,000-tonne methanol facility of Tianye Chemical.

In 2006, the Group's remaining costs of sales amounted to RMB143.2 million (mainly comprises of the costs of port operation, the provision of transportation services and the manufacture and sales of woven plastic bags), representing an increase of RMB30.8 million from RMB112.4 million of last year, or an increase of 27.4%. The main reason for the increase was the increased cost of RMB36.1 million for port operation and the provision of transportation services, albeit such operations as compound fertilizer processing and sales of woven plastic bags decreased the cost by RMB5.3 million.

## Gross profit

The Group's gross profit in 2006 was RMB1,301.6 million, representing an increase of RMB223.7 million from RMB1,077.9 million of last year, or an increase of 20.75%. Such increase was mainly attributable to the acquisition of Tianye Chemical and the commencement of commercial production of the CNOOC Jiantao 600,000-tonne methanol plant.

In 2006, the gross profit of the Group's urea segment was RMB1,145.1 million, representing an increase of RMB101.1 million from RMB1,044 million of last year, or an increase of 9.68%. The increase was mainly due to (1) an increase in the gross profit from Tianye Chemical of RMB198.9 million; (2) an increase of RMB26.7 million in the gross profit from the current year increase in the sales volume of urea of 29,300 tones.

In 2006, the gross profit of the Group's methanol segment amounted to RMB118.3 million, containing the gross profit generated by Tianye Chemical's 200,000-tonne methanol plant and the CNOOC Jiantao's 600,000-tonne methanol plant; both were put into commercial productions in 2006.

In 2006, the Group's gross profit from other segment (mainly comprises of segments engaged in port operation, the provision of transportation services and the manufacture and sales of woven plastic bags) amounted to RMB38.2 million, representing a slight increase of RMB4.5 million from RMB33.7 million compared with 2005.

## Other income and gains

The Group entered into a cross-currency interest rate swap contract (the "swap") with the Bank of China Hainan Branch to sell US dollars ("USD") in exchange for Japanese Yen ("JPY") in order to partially offset the potential fluctuation in the future repayments of certain Japanese Yen denominated loans (the "Japanese Yen loan") and their interest payments in USD equivalent. The swap contract will expire by 20 June 2008. The Group recorded a fair value gain of RMB25.0 million on the swap in 2006.

Other income and gains greatly increased from RMB1.7 million in 2005 to RMB125.6 million in 2006, which was mainly due to the recognition of cash VAT refunds of RMB89.3 million in 2006. The refunds were made by the PRC government in respect of part of the VAT paid by the Group on the sale of its urea products in year 2004 and the first half of 2005.

## Excess over the cost of a business combination

Due to the acquisition of Tianye Chemical, the Group recorded an excess over the cost of a business combination of RMB577.6 million in 2006, which represented the excess of the Company's interests in the net fair value of Tianye Chemical's identifiable assets, liabilities and contingent liabilities over the cost of its acquisition. In 2005, the excess over the cost of a business combination was nil.

## Selling and distribution costs

The Group's selling and distribution costs amounted to RMB33.9 million for the year ended 31 December 2006, representing an increase of RMB18.5 million from RMB15.4 million compared with 2005, or an increase of 120.13%. The increase was mainly due to the addition of the selling and distribution costs of Tianye Chemical and CNOOC Jiantao for the year ended 31 December 2006. Without considering the selling and distribution costs of Tianye Chemical and CNOOC Jiantao of RMB15.3 million and RMB5.2 million for the year ended 31 December 2006 respectively, the Group's selling and distribution costs for the year ended 31 December 2006 would remain comparable with that of 2005.

## Administrative expenses

The Group's administrative expenses amounted to RMB199.6 million for the year ended 31 December 2006, representing an increase of RMB68.9 million from RMB130.7 million compared with 2005, or an increase of 52.72%. The increase was mainly due to (1) the consolidation of Tianye Chemical which contributed RMB62.8 million to the Group's administrative expenses for the year ended 31 December 2006; and (2) the establishment of new departments designated for business development, procurement, treasury and internal audit.

## Other expenses

The Group's other expenses amounted to RMB34.5 million for the year ended 31 December 2006, representing a decrease of RMB68.6 million from RMB103.1 million of last year, or a decrease of 66.54%. The decrease was mainly because the Group recorded a fair value loss on the swap of RMB67.9 million in 2005 but recorded a fair value gain on the swap of RMB25.0 million in 2006, which was recorded as other income and gains.



## Finance revenue

In 2006, the Group's finance revenue amounted to RMB119.8 million, representing an increase of RMB95.4 million from RMB24.4 million compared with 2005, or an increase of 390.98%. The surge was mainly due to the receipt of the bank interest income of RMB88.9 million from the subscription monies of the Company's H Shares and the increase in the contribution of finance revenue of RMB3.7 million from Tianye Chemical.

## Finance costs

In 2006, the Group's finance costs amounted to RMB61.7 million, representing an increase of RMB46.2 million from RMB15.5 million compared with 2005, or an increase of 298.06%. The increase was mainly due to the interest costs incurred on the short-term entrusted loan from CNOOC of RMB1,410 million and the short-term commercial bank loans of RMB2,570 million obtained during the year.

## Exchange gain/(loss), net

In 2006, the Group recorded an exchange loss of RMB1.5 million, primarily due to the exchange loss arising from the purchase of Japanese Yen to repay part of the Japanese Yen loan. In 2005, the Group recorded an exchange gain of RMB189.5 million, which was mainly due to the 13.8% depreciation of Japanese Yen against RMB from 31 December 2004 to 31 December 2005.

## Share of profits of associates

In 2006, the Group's share of profits of associates amounted to RMB1.8 million, representing a slight decrease compared with the share of profits of associates of RMB1.9 million in 2005.

## Profit before tax

In 2006, the Group's profit before tax amounted to RMB1,795.3 million, representing an increase of RMB764.6 million from RMB1,030.7 million of last year, or an increase of 74.18%. The increase arose from the recognition of a one-off excess over the cost of a business combination of RMB577.6 million arising from the acquisition of Tianye Chemical; the consolidation of the profit before tax of Tianye Chemical in 2006 of RMB143.1 million, the

receipt of cash VAT refunds of RMB89.3 million, the contribution of profit before tax from CNOOC Jiantao of RMB73.4 million and the receipt of the bank interest income of RMB88.9 million from the subscription monies of the Company's H Shares.

## Income tax expenses

In 2006, the Group recorded an income tax expense of RMB120.1 million, an increase of RMB72.6 million from RMB47.5 million of last year, or an increase of 152.84%. In 2005, the Group's effective income tax rate was 4.6% and was 6.7% in 2006. The increase was mainly due to the expiration of the exempted corporate income tax period of Fudao Phase II. Since Fudao Phase II was subject to corporate income tax at the rate of 7.5% in 2006 (0.0% in 2005), the income tax expenses of the Group therefore increased by RMB38.1 million in 2006. Furthermore, the addition of the current year income tax expenses of CNOOC Jiantao of RMB9.7 million also contributed to the increase in the current year income tax expenses.

## Profit after tax

The Group's profit after tax for 2006 amounted to RMB1,675.2 million, representing an increase of RMB692.0 million from RMB983.2 million of last year, or an increase of 70.38%. This represented an excess of RMB214.7 million or 14.70% over the forecast profit of RMB1,460.5 million stated in the prospectus. The increase was mainly due to the contribution of profit after tax of RMB63.8 million from CNOOC Jiantao and the bank interest income, net of tax, of RMB82.2 million arising from the subscription monies of the Company's H Shares.

## Dividend

In 2006, the Company paid a special dividend of RMB264.5 million to CNOOC, representing the net profit generated from 1 January 2006 to 24 April 2006 (being the day before the establishment of the Company as a joint stock limited company), and a special dividend of RMB302.1 million to the Company's promoters, representing the net profit generated from 25 April 2006 to 31 August 2006 (being the last day of the month immediately before the listing of the Company's H shares). The total dividend payment for the aforementioned period amounted to RMB566.6 million.

In addition, the board of directors of the Company (the "Board")

recommended the payment of a final dividend of RMB1.5 fen per Share, equivalent to RMB69.2 million for 2006. The proposed final dividend for the year is subject to the approval of the Company's shareholders at the forthcoming annual general meeting.

### Solvency and capital resources

As at 1 January 2006, the Group had cash and cash equivalents of RMB1,719.8 million, and the net cash inflow from operating activities for the year 2006 amounted to RMB1,764.8 million, net cash outflow from investing activities amounted to RMB1,274.6 million, net cash outflow from financing activities amounted to RMB160.5 million. As at 31 December 2006, the Group's cash and cash equivalents amounted to RMB2,049.5 million.

### Cash flows from operating activities

In 2006, net cash generated from operating activities amounted to RMB1,764.8 million, an increase of RMB847.7 million from RMB917.1 million of the previous year, or an increase of 92.43%. The increase was mainly due to (1) the operating profit before changes in working capital amounted to RMB1,163.8 million in 2005, and in 2006 increased to RMB1,649.1 million; (2) trade receivables, bills receivable, prepayments, deposits and other receivables reduced by RMB33.1 million following the significant decrease in export sales during the year; and (3) trade payables, other payables, accruals and other long-term liabilities reduced by RMB232.0 million in 2006, all of the above increased the cash from operating activities by RMB898.7 million in total, and offset the increase in operating profit of RMB764.7 million and depreciation expenses of RMB242.3 million.

### Capital expenditure

The Group's capital expenditure for 2006 was RMB1,559.4 million, of which, the capital expenditure for the acquisition of Tianye Chemical amounted to RMB964.6 million, and the capital expenditure for the acquisition of minority interests in Hainan Complex Fertilizers Company Limited amounted to RMB5.1 million. The current year capital expenditure for the 600,000-tonne methanol project amounted to RMB278.0 million. The current year capital expenditure for the construction of the liquid chemical berth for the 600,000-tonne methanol plant amounted to RMB115.0 million. The current year capital expenditure for the Tianye Chemical's 200,000-tonne methanol facility was RMB24.0 million. The capital expenditure for Fudao Phase I, Fudao Phase II and Tianye Chemical

was RMB127.1 million, and other capital expenditure for the year was RMB45.6 million.

The completion of the construction of the liquid chemical berth for the 600,000-tonne methanol plant at the Port of Basuo was slightly delayed. Environmental assessment is required on the 60,000-tonne polyoxymethylene project and it was delayed than initially expected.

### Cash flows from investing activities

In 2006, the Group's net cash used in investing activities amounted to RMB1,274.6 million, an increase of RMB913.2 million from RMB361.4 million compared with 2005, or an increase of 252.68%. It was mainly due to the payment of a cash consideration of RMB892.2 million for the acquisition of Tianye Chemical (net of cash proceeds and cash equivalents acquired), and the addition of intangible assets of RMB15.6 million and rental prepayment of newly acquired leasehold land in the amount of RMB59.1 million.

### Cash flows from financing activities

In 2006, the Group's net cash outflow from financing activities amounted to RMB160.5 million, representing a decrease of RMB212.7 million from an inflow of RMB52.2 million compared with 2005. It was mainly due to (1) the receipt of the net proceeds of RMB2,932.3 million from the issue of the Company's H shares; (2) the obtaining of bank and other borrowings amounting to RMB4,283.4 million; (3) the repayment of bank and other borrowings of RMB4,698.3 million (including the partial repayment of the Japanese Yen loan in order to minimize the risk of exchange rate fluctuations of Japanese Yen faced by the Group); and (4) the payment of dividends of RMB1,777.5 million in 2006.

### Market risk

The major market risks the Group is exposed to include the risk of interest rate, fluctuations in exchange rate and changes in the selling prices of the Group's key products and changes in the prices of raw materials.

### Risk of interest rate

As at the end of 2006, approximately 60% of the outstanding indebtedness of the Group bear interest at fixed interest rates, in

## Risk in foreign exchange

The Group's sales revenues are denominated in Renminbi and US dollars. Since 21 July 2005, the PRC government has been maintaining a stable exchange rate for Renminbi which will be adjusted by the supply and demand of the market, adjusted with reference to a basket of currencies and the floating rate. Renminbi is no longer linked solely to the US dollars. Since that date until the end of 2006, Renminbi appreciated against the US dollars by 3.35%.

Appreciation of Renminbi against the US dollars may have a double effect. The sales revenues of the Group's products may be reduced as a result of the conversion into Renminbi from prices denominated in US dollars, but the cost of import for the purchase of equipment and raw materials will also be reduced. Moreover, the appreciation of Renminbi may reduce the Group's burden of indebtedness denominated in US dollars.

As at the end of 2006, the balance of the Group's indebtedness in Japanese Yen amounted to JPY3,338.1 million, and the Group has already entered into swap contracts to partially offset the potential fluctuation in the future repayments of the Japanese Yen loan.

## Risk of inflation and currencies

The inflation in previous years in China had no significant impact on the Group's operating results. According to the information of the National Statistics Bureau of China, from 2003 to 2006, changes in the consumer price index of China were 1.2%, 3.9%, 1.8% and 1.5% respectively.

## Risk in commodity prices

The Group is also exposed to the risk of commodity prices as a result of the changes in the prices of products and the costs of raw materials (mainly natural gas).

## post balance sheet events and contingent liabilities

During the 5th Session of the 10th National People's Congress, which was concluded on 16 March 2007, the PRC Enterprise Income Tax Law ("the New Enterprise Income Tax Law") was approved and will become effective on 1 January 2008. The New Enterprise Income Tax Law introduced changes which include, but not limited to, the unification of the enterprise income tax rate for domestic-invested and foreign-invested enterprises at 25%. Since the detailed implementation and administrative rules and regulations have not yet been announced, the financial impact of the New Enterprise Income Tax Law to the Group cannot be reasonably estimated at this stage.

As at 31 December 2006, the Group had no contingent liabilities.

## Use of proceeds

In 2006, the proceeds were used according to the uses set out in the prospectus.

## Outlook

In 2007, the economy of China will see consistent rapid growth. The PRC government will continue to emphasize most on the three agricultural issues (agriculture, rural areas and farmers), with policies to protect farmlands, to increase the minimum prices for agricultural produce and the overall subsidies for farmers, thus creating a very favorable environment for agriculture. Mineral fertilizers enterprises continue to enjoy the exemption from VAT and the export duty for urea will remain at the same level of last year. As an overview of the urea market in 2007, it is estimated that in 2007 the speed of increase in the supply of urea in China will be slightly higher than the speed of increase in demand, but overall there still remains in an equilibrium of supply and demand. Since the prices of coal, electricity, natural gas, railway transportation and sea-land transportation are rising, the prices of urea in overseas will remain at higher levels, thus supporting the prices of urea in China. It is estimated that the price of urea will be maintained at similar levels as in 2006, but there will still be seasonal fluctuations.

In spite of the fact that, since December 2006, China has opened the wholesale and retail markets for the mineral fertilizers industry to foreign investors, for the years to come, competition of China's mineral fertilizers will mainly be confined within domestic companies. At present, there are approximately over 200 urea facilities in China, with low concentration of industry and the operation scale





of these enterprises are relatively small. In the wake of the change in the supply and demand relationship, the government's construction of "energysaving and environmentally friendly" enterprises and market driven reforms of the mineral fertilizer industry, the mineral fertilizer industry will see a change where only the fittest will survive, with structural adjustment and increase in activities in merger and acquisition towards the direction of industry concentration of production capacity. Certain enterprises with competitive strength will be able to capture such opportunities for rapid development. In 2007, increase in the demand for methanol mainly lies in acetic acid and methanol fuel. It is estimated that supply and demand will remain balanced. However, the uneven geographical distribution causes a shortage in eastern China and southern China regions which will require supply from import. However, newly added production capacity put into operation globally may have certain impact on the methanol market.

Looking into 2007, the Company will continue to adhere to its corporate culture of "integrity, harmony, innovation and dedication" to achieve the following objectives:

1. Enhance management of production, quality, health, safety and environmental to control production costs;
2. Commence large-scaled methanol and POM projects as scheduled;
3. Continue research and development for new projects;
4. Push forward the merger and acquisition of other mineral fertilizer enterprises;
5. Accomplish trial of soil testing projects and distribution work on mineral fertilizers;
6. Improve internal control system.