

REPORT of the DIRECTORS

The Directors are pleased to present their first report and the Company's and the Group's audited financial statements for the year ended 31 December 2006.

Principal activities

The Company is principally engaged in the manufacture and sales of mineral fertilizers. The principal activities of the subsidiaries and jointly-controlled entities comprise the manufacture and sale of mineral fertilizers and chemical products. There were no significant changes in the nature of the Company's principal activities during the year.



Results

The Group's profit for the year ended 31 December 2006 and the Company's and the Group's financial position as at that date are set out on pages 53 to 55 of the financial statements.

Dividends

In 2006, the Company paid a special dividend of RMB264.5 million to CNOOC for the period from 1 January 2006 to 24 April 2006 (being the day immediately before the incorporation of the Company as a joint stock limited company), and another special dividend of RMB302.1 million to the Company's promoters for the period 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 Directors recommend the payment of a final dividend of RMB1.5 fen per share in respect of the year to all shareholders on the register of members of the Company on 15 June 2007 subject to the shareholders' approval in the annual general meeting on 15 June 2007. This dividend together with the special dividends aforesaid amounts to RMB635.8 million in total. Further details of this accounting treatment are set out in note 13 to the financial statements.

Dividend to shareholders of domestic shares will be paid in Renminbi whereas dividend to shareholders of H shares will be paid in Hong Kong Dollars. The value of Hong Kong Dollar shall be calculated on the basis of the average exchange rate of Renminbi and Hong Kong Dollar

announced by the People's Bank of China one week before the date of the declaration of dividend.

The final dividend will be paid on or about 18 June 2007.

Use of proceeds from the Company's initial public offering and placing of new shares

The net proceeds from the IPO and placing (net of related issuance expenses) amounted to approximately RMB2,932.3 million. According to the explanation in the Company's prospectus, approximately RMB1,400 million of the net proceeds from the IPO and placing were used to finance the construction of a production facility for the manufacture of polyoxymethylene at Tianye Chemical Plant, approximately RMB1,410 million were used to repay the Japanese yen bank loans and the remaining balance was used for working capital. The aforesaid uses will remain unchanged.

Subsidiaries

Particulars of the Company's subsidiaries as at 31 December 2006 are set out in note 19 to the financial statements.

Summary financial information

A summary of the published results and assets and liabilities of the Group for the last four financial years is set out on page 2. This summary does not form part of the audited financial statements.

Property, plant and equipment

Details of movements in the property, plant and equipment of the Company and the Group during the year are set out in note 15 to the financial statements.

Share capital

As at 31 December 2006, the aggregate share capital of the Company was RMB4,610,000,000 divided into 4,610,000,000 ordinary shares with a nominal value of RMB1 each, of which 2,839,000,000 were Domestic Shares representing approximately 61.58% of the aggregate number of shares in issue, and the remaining 1,771,000,000 shares were H shares representing approximately 38.42% of the aggregate number of shares in issue.

Details of movements in the Company's share capital during the year are set out in note 30 to the financial statements.

Pre-emptive rights

There are no provisions for pre-emptive rights under the Company's Articles of Association or the Company Law of the PRC which would oblige the Company to offer new shares on a pro rata basis to existing shareholders.

Purchase, sale or redemption of listed securities of the Company

Neither the Company, nor any of its subsidiaries purchased, redeemed or sold any of the Company's listed securities during the year.

Reserves

Details of movements in the reserves of the Company and the Group during the year are set out in note 31 to the financial statements and in the consolidated statement of changes in equity, respectively.

Distributable reserves

Details of reserves available for distribution are set out in note 31 to the financial statements.

Charitable contribution

During the year, the Group made charitable contributions totaling RMB2,942,000.

Major customers and suppliers

During the reporting period, sales to the Group's five largest customers accounted for 36.98% of the total sales for the year and sales to the largest customers included therein amounted to 10.40%. Purchases from the Group's five largest suppliers accounted for 76.55% of the total purchases for the year and purchases from the largest supplier included therein amounted to 24.18%.

The Group has purchased raw materials and services from certain companies with the same ultimate holding company as the Company, details of which are set forth in the note "Connected Transactions" below. Save as aforesaid, none of the Directors of the Company or any of their associates or any shareholders (which, to the best knowledge of the Directors, own more than 5% of the Company's issued share capital) had any beneficial interest in the Group's five largest customers and five largest suppliers.



Directors and Supervisors

The Directors and Supervisors of the Company during the year were

Executive Directors :

YANG Yexin	(appointed on 25 April 2006)
FANG Yong	(appointed on 25 April 2006)
CHEN Kai	(appointed on 25 April 2006)

Non-executive Director:

WU Mengfei	(appointed on 25 April 2006)
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Independent Non-executive Directors:

WANG Wenshan	(appointed on 25 April 2006)
ZHANG Xinzhi	(appointed on 25 April 2006)
WU Xiaohua	(appointed on 3 July 2006)
TSUI Yiu Wa, Alec	(appointed on 25 April 2006)

Supervisors:

YIN Jihong	(appointed on 25 April 2006)
HUANG Jinggui	(appointed on 25 April 2006)
QU Bin	(appointed on 25 April 2006)

In accordance with the Company's Articles of Association, all Directors and supervisors are elected for a term of three years and may serve consecutive terms upon re-election.

The Company has received the annual confirmations of independence from each of the Independent Non-Executive Directors as at the date of this annual report and still considers them to be independent.



Directors, Supervisors and Senior Management

Biographical details of the Directors and Supervisors of the Company and the senior management of the Group are set out on pages 36 to 39 of this annual report.

Service contracts of Directors and Supervisors

Each of the Directors and Supervisors is required to enter into a service contract with the Company for a term of three years, renewable upon re-election.

Other than the foregoing, no Director has a service contract with the Company which is not determinable by the Company within one year without payment of compensation, other than statutory compensation.

Remuneration of the Directors and Supervisors

Details of the Directors' and Supervisors' remuneration are set out in note 9 to the financial statements.

The interests of Directors and Supervisors in contracts

None of the Directors and Supervisors had a material interest, either directly or indirectly, in any material contract in relation to the business of the Group to which the Company, its holding company, or any of its subsidiaries or fellow subsidiaries was a party during the year.

Directors' and Supervisors' Interests in shares and Short Positions

As at 31 December 2006, none of the Directors and Supervisors or their associates had or was deemed to have any interest or short position

in the shares, underlying shares or debentures of the Company or any of its associated corporations (within the meaning of Part XV of the Securities and Futures Ordinance (the "SFO") which were required to be notified to the Company and the HKEX pursuant to Divisions 7 and 8 of Part XV of the SFO (including interests and short positions which they were deemed or taken to have under such provisions of the SFO, or which were required to be entered in the register pursuant to section 352 of the SFO, or which were required, pursuant to the Model Code for Securities Transactions by Directors of Listed Issuers, to be notified to the Company and the Stock Exchange.

Directors' and Supervisors' rights to acquire shares or debentures

None of the Directors and Supervisors has the rights to acquire shares or debentures.

Substantial Shareholders' Interests

As at 31 December 2006, the shareholders (other than the Company's Directors and Supervisors) who had interests or short positions in the shares and underlying shares of the Company as recorded in the register, which is required to be kept pursuant to Section 336 of the SFO, are as follows:

Name of Substantial Shareholder	Capacity	Number of Shares and Nature of interests	Class of Shares	Approximate percentage of the relevant class of shares in issue(%)	Approximate percentage of total issued shares (%)
CNOOC	Beneficial owner	2,738,999,512 (L)	Domestic Shares	97.33	59.41
Yara Nederland BV	Beneficial owner	161,000,000 (note ii) (L)	H Shares	9.10	3.49
Sunny Smart Limited ("Sunny Smart")	Beneficial owner	102,324,000 (note ii) (L)	H Shares	5.78	2.22

Notes:

The letter "L" denotes long position.

i. Yara Nederland BV is a wholly-owned subsidiary of Yara International ASA.

ii. Sunny Smart is a wholly-owned subsidiary of Neway Century Limited. Neway Century Limited is a wholly-owned subsidiary of China Entertainment & Land Investment Limited, which is in turn a wholly-owned subsidiary of Chinese Estates Holdings Limited ("Chinese Estates").

Based on the information available on the website of HKEX, a discretionary trust, which Lau Luen Hung, Joseph is the founder and GZ Trust Corporation is the trustee, appears to hold a controlling interest in Chinese Estates.

As disclosed in the Company's Prospectus dated 18 September, 2006, each of the following corporate investors has entered into corporate placing agreements with the Company, and were interested in 5% or more of the issued H shares of the Company as at 31 December 2006:

Name of Substantial Shareholder	Capacity	Number of Shares and Nature of interests (note i)	Class of Shares	Approximate percentage of the relevant class of shares in issue(%)	Approximate percentage of total issued shares (%)
Bestlane Limited ("Bestlane")	Beneficial owner	118,902,439 (note ii) (L)	H Shares	6.71	2.58
Bank of China Group Investment Ltd. ("BOCGI")	Beneficial owner	95,121,951 (L) (note iii)	H Shares	5.37	2.06

Notes:

The letter "L" denotes long position.

i. Please refer to the Section headed "Corporate Placing" under "Strategic Investment and Corporate Placing" in the Prospectus for details of the corporate placing agreements.

ii. Bestlane is a company incorporated in the British Virgin Islands and is indirectly wholly-owned by Shau Kee Financial Enterprises Limited, which is in turn wholly-owned by Lee Financial (Cayman) Limited of which Dr. Lee Shau Kee is a substantial shareholder.

iii. BOCGI is a wholly-owned subsidiary of Bank of China Limited.

Save as disclosed above and so far as the Directors are aware, as at 31 December 2006, no other person had an interest or short position in the Company's shares or underlying shares which would fall to be disclosed to the Company and the Stock Exchange under section 336 of the SFO.

Connected transactions

Upon the listing of the H shares of the Company on the HKEX on 29 September 2006, transactions between the Group and its connected persons or their respective associates (as the respective terms are defined by the HKEX Listing Rules) are governed by and required to comply with the requirements of the HKEX Listing Rules. During the year ended 31 December 2006, the Group had the following connected transactions:

	2006
	RMB'000
A. Annual revenue earned from sales of products and provision of services:	
1. CNOOC and its associates	
Sale of products	12,168
2. Hong Kong Kingboard and its associates	
Sale of products	117,834
3. Hainan CNOOC Transportation Co., Ltd	
Provision of loading services	17,588
4. CNOOC and its associates	
Provision of services and supplies	903
B. Annual expenditure for acquiring products and services:	
1. CNOOC and its associates	
Acquire comprehensive services and supplies	130,867
2. CNOOC China Limited	
Purchase of nature gas	416,861
3. COSL	
Acquire transportation services	7,177
4. Hainan CNOOC Transportation Co., Ltd	
Acquire transportation services	4,277
C. Other major connected transactions:	
1. Maximum daily outstanding balance of loans (including accrued interest) granted by CNOOC Finance to the Group after listing	62,399
2. Maximum daily outstanding balance of deposits (including accrued interest) placed by the Group with CNOOC Finance after listing	293,839

Besides item A (1) of the above items, a waiver has been granted by the HKEX to the Company from the strict compliance with the requirement of the connected transaction of the HKEX Listing Rules in respect of the connected transactions set out above. The sales revenue pointed out in item A (1) has exceeded the minimis threshold under Rule 14A.33 of the Listing Rules, and will be announced under Rule 14A.34 of the Listing Rules.

The Independent Non-executive Directors have reviewed the above transactions and have confirmed that:

1. the transactions were entered into between the Group and the connected persons or their respective associates (if appropriate) in the ordinary and usual course of its business.
2. the transactions were entered into on normal commercial terms, or where there is no available comparison, on terms no less favorable than those available from or to independent third parties;
3. the transactions were entered into in accordance with the relevant agreements governing such transactions, on terms that are fair and reasonable to the independent shareholders as a whole;
4. the transactions were entered into with the annual aggregate value of each category of connected transactions not exceeding the relevant annual limits as approved by the independent shareholders.

The auditors have reviewed the foregoing transactions and have provided a letter to the Company stating that:

1. the transactions have received the approval from the Board;
2. the transactions have been entered into in accordance with the pricing policies as stated in the relevant agreements;
3. the transactions have been entered into in accordance with the terms of the relevant agreements governing such transactions;
4. the transactions ,where applicable, did not exceed the annual cap amounts as agreed with the HKEX.

Sufficiency of public float

Based on information that is publicly available to the Company and within the knowledge of the Directors, 38.42% of the Company's total issued share capital was held by the public as at the date of this annual report, meeting the requirement that at least 25% of the total share capital shall be held by the public.

Post balance sheet events

Details of the significant post balance sheet events of the Group are set out in note 44 to the financial statements.

Material Legal Proceedings

As at 31 December 2006, the Company was not involved in any material litigation or arbitration and no material litigation or claims was pending or threatened or made against the Company so far as the Company is aware.

Audit Committee

The annual results have been reviewed by the audit committee of the Board which consists of three Independent Non-executive Directors. The committee has reviewed the accounting principles and practices adopted by the Company, and has also discussed the auditing, internal control and finance reporting matters including the review of the audited 2006 annual results with the management.

Code on Corporate Governance Practices and Model Code for Securities Transactions

The Company is committed to high standards of corporate governance through the establishment of an efficient framework of policies, procedures and systems. The Directors are of the opinion that the Company has complied with the code provisions of the Code on Corporate Governance Practices as set out in Appendix 14 of the Listing Rules throughout the year.

Auditors

The financial statements of this year have been audited by Ernst & Young who retire and a resolution for their reappointment as auditors of the Company will be proposed at the forthcoming annual general meeting.

On behalf of the Board

Wu Mengfei

Chairman

Hong Kong, 3 April 2007