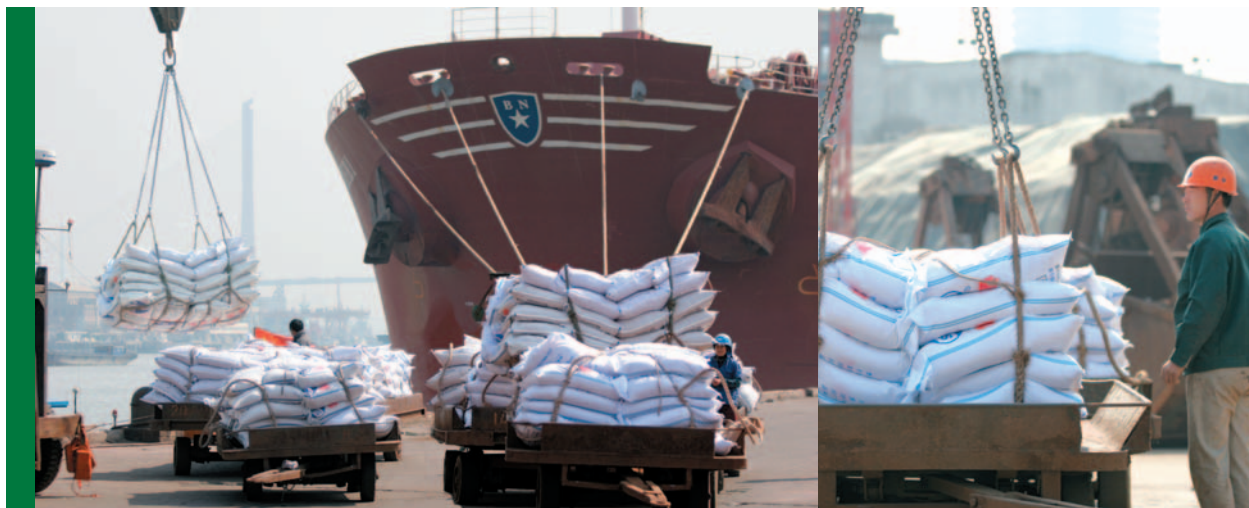


## Management's Discussion and Analysis



For the twelve months ended 31 December 2006, sales volume of the Group reached 12.57 million ton, turnover was HK\$21,127 million, representing an increase of 12.56% and 9.76%, respectively, over the corresponding period of 2005.

For the twelve months ended 31 December 2006, gross profit of the Group reached HK\$1,707 million, net profit was HK\$896 million, representing an increase of 10.66% and 14.99%, respectively, over the corresponding period of 2005.

### I. Operation Scale

#### 1. Sales volume

For the twelve months ended 31 December 2006, sales volume of the Group reached 12.57 million ton, up by 12.56% over the corresponding period of 2005. Due to the impact of the prolonged potash contract negotiations, the sales of imported fertilizers decreased from 6.36 million ton in 2005 to 5.3 million ton in 2006, representing a decrease of 16.53%. By vigorously expanding domestic fertilizer business operations, sales of domestic fertilizers increased from 3.85 million ton in 2005 to 6.36 million ton in 2006, representing an increase of 65.07%. In 2006, the sales of domestic fertilizers exceeded that of imported fertilizers by 19.80%.

In terms of product structure, the sales of potash fertilizers decreased by 19.97% year on year, which was caused mainly by the suspension of potash import during first half 2006 due to the prolonged potash contract negotiations. The sales of nitrogen fertilizers increased by 104.64%, which was mainly attributable to the Group's innovative resource acquisition method - setting up a core supplier system by consolidating strategic alliances with suppliers through capital bonds, as well as to the expansion of the distribution network. The sales of compound fertilizers grew by 34.35% year on year, which was mainly attributable to the increase of both imported and domestic compound fertilizers. The sales of phosphate fertilizers remained basically the same as that of the corresponding period of last year. If the sales of rock phosphate were deducted from the 2005 figure, the sales of phosphate fertilizers would have been increased by 15.96%, which was attributable to the increased sales of domestic phosphate fertilizers.

## Management's Discussion and Analysis



### 2. Turnover

For the twelve months ended 31 December 2006, turnover of the Group reached HK\$21,127 million, up by HK\$1,878 million over the corresponding period of 2005, or an increase of 9.76%, which was slightly lower than the 12.56% increase rate of sales volume. This was mainly due to the decreased sales of potash fertilizers, which were of higher prices, but the increased sales of low-priced nitrogen fertilizers.

**Table 1:**

	For the twelve months ended 31 December 2006		For the twelve months ended 31 December 2005	
	Turnover HK\$'000	As percentage of total turnover	Turnover HK\$'000	As percentage of total turnover
Potash fertilizers	<b>8,545,679</b>	<b>40.45%</b>	10,122,007	52.59%
Nitrogen fertilizers	<b>5,156,519</b>	<b>24.41%</b>	3,010,152	15.64%
Compound fertilizers	<b>3,889,163</b>	<b>18.41%</b>	2,807,174	14.58%
Phosphate fertilizers	<b>2,813,010</b>	<b>13.31%</b>	2,641,101	13.72%
Others	<b>722,200</b>	<b>3.42%</b>	668,231	3.47%
<b>Total</b>	<b>21,126,571</b>	<b>100.00%</b>	19,248,665	100%

## Management's Discussion and Analysis



### II. Profit

#### 1. Gross profit margin

For the twelve months ended 31 December 2006, gross profit margin of the Group was 8.08%, which was slightly higher than that for the corresponding period of 2005.

The changes of gross profit margins of various products are as follows: Due to the suspension of sea-borne potash import caused by the prolonged potash contract negotiations, the Group made full utilization of its potash inventories and Group adopted different marketing strategies in specific regional markets, which had helped to increase the gross profit margin of potash fertilizers on a year on year basis. The gross profit margin of nitrogen fertilizers also increased thanks to the improved supply chain management and the enhanced efficiency of the distribution network operations. The gross profit margin of phosphate fertilizers decreased on a year on year basis due to increased domestic production and market price fluctuations. The gross profit margin of compound fertilizers also decreased on a year on year basis, which was mainly due to oversupply in the domestic market.

#### 2. Share of results of jointly controlled entities

For the twelve months ended 31 December 2006, the share of results of jointly controlled entities of the Group was HK\$41 million, which was mainly from Hubei Dongfang, Sinochem Kailin, Yunan Three Circle-Sinochem-Cargill and other plants. This figure was down by 17.83% from that of HK\$50 million for the corresponding period of 2005. This was mainly caused by lowered profitability of the production enterprises, which was the result of increased cost of raw materials for phosphate and compound fertilizer production, making the industrial average profitability declined.

## Management's Discussion and Analysis



### 3. Income tax expense

For the twelve months ended 31 December 2006, income tax expense of the Group was HK\$99 million, and the taxation burden was 9.88%. For the corresponding period of 2005, the income tax expense was HK\$138 million, and the taxation burden was 14.79%. A comparison shows that the taxation burden is lowered, which is mainly attributable to that the business of the Group is chiefly conducted in China's mainland, Macao and Hong Kong, at which the income tax rates vary. PRC income tax rate is 33%, profit derived in Macao is exempted from income tax, while Hong Kong profits tax rate is 17.5%. The Company strictly abides by the taxation laws of the three jurisdictions and pays taxes accordingly. In 2006 the expansion of the distribution network incurred higher shipment cost, railway tariffs increased, and expenditure on agrichemical services and brand promotions rose. These factors led to increases in selling and distribution cost in the PRC, which lowered the profit before income tax, and consequently reduced income tax expense in the PRC, thus lowering the Group's overall taxation burden.

Income tax rates applicable to the Group are set out as below:

1. PRC enterprise income tax applicable to the Group's subsidiaries operating in the PRC is 33% (2005: 33%). Certain subsidiaries of the Group in the PRC are entitled to preferential income tax treatments which are detailed below:
  - (a) Sinochem Chongqing Fuling Chemical Fertilizer Company ("Sinochem Fuling"), a 60% owned subsidiary of the Group, is currently subject to a preferential PRC enterprise income tax rate of 15% granted by the local tax bureau of Chongqing City in July 2001. According to the policy for the development of the Western region of the PRC promulgated by the State Council, Sinochem Fuling is entitled to this preferential income tax treatment from 2002 to 2010 provided it is engaged in the projects listed in the Catalogue for Industries, Products and Technologies Currently and Particularly Encouraged by the State for Development (as amended in 2000) and its principal business and revenue from the principal operations accounts for over 70% of its total revenue.

## Management's Discussion and Analysis

(b) Fujian Sinochem Zhisheng Chemical Fertilizer Company Limited ("Sinochem Zhisheng"), a 53.19% owned subsidiary of the Group, is currently entitled to a preferential income tax treatment granted by the State Tax Bureau of Fujian province. Pursuant to such preferential income tax treatment, the amount invested in domestically made machinery by Sinochem Zhisheng in a particular year under its technological renovation project for compound fertilizer production can be applied to set off against the enterprise income tax of the preceding year.

2. Profit derived in Macao is exempted from income tax.
3. Hong Kong Profits Tax is calculated at 17.5% (2005: 17.5%) of the estimated assessable profit for the year.

#### 4. Net profit and net profit margin

For the twelve months ended 31 December 2006, the Group realized net profit of HK\$896 million, up by 14.99% over that of HK\$779 million for the corresponding period of 2005. This was mainly attributable to an increase of HK\$164 million in gross profit caused by a stable gross profit margin and enlarged sales volume. The net profit margin was 4.24%, up by 0.19 percentage points over that of 4.05% for the corresponding period of 2005.

### III. Expenditures

**Selling and distribution expenses** for the twelve months ended 31 December 2006 was HK\$535 million, up by 35.54% over that of HK\$395 million for the corresponding period of 2005. It was mainly attributed to the year-on-year increase in sales volume which incurred proportionally higher expenses in transportation and warehousing, and increased railway tariffs, as well as rising expenditure on agrichemical services and brand promotions.

**Administrative expense** for the twelve months ended 31 December 2006 was HK\$187 million, down by 16.10% from that of HK\$223 million for the corresponding period of 2005. If the effect of the "provision for impairment of inventories" were readjusted, administrative expense would have been up by HK\$29 million, or 15.63% year on year, which was mainly caused by increased expenditures arising from the expansion of the distribution network.

**Finance cost** for the twelve months ended 31 December 2006 was HK\$129 million, up by 14.46% over that of HK\$112 million for the corresponding period of 2005, which was mainly due to increased capital use caused by increased sales volume.

## Management's Discussion and Analysis

### IV. Cash Flow

Cash inflow of the Group for the twelve months ended 31 December 2006 was HK\$10 million, which includes:

1. a cash inflow of HK\$77 million from business operations attributable to lowered inventories, faster turnover, and timely collection of receivables;
2. a cash outflow of HK\$290 million to investment activities, i.e., HK\$300 million for property, plants and equipment purchase, HK\$241 million for the purchase of shares Luxi Chemical and Hualu Hengsheng, HK\$191 million received from disposal of investment properties, and HK\$44 million received from investment returns; and
3. a cash inflow of HK\$223 million from financing activities, i.e., proceeds of HK\$1,272 million received in cash from the issue of convertible bonds, HK\$834 million in repayment of bank loans, HK\$117 million in dividend payout, and HK\$96 million in payment for interest.

### V. Inventory Turnover

The inventory balance of the Group as at 31 December 2006 was HK\$4,365 million, decreasing by 9.04% from HK\$4,798 million as at 31 December 2005. Due to faster turnover rate, inventory turnover day(note) decreased from 90 days in 2005 to 85 days in 2006, thus improving assets operating efficiency.

*Note: Calculated on the basis of average inventory balance as at the end of the reporting period divided by cost of goods sold, and multiplied by 365 days.*

### VI. Trade and Bills Receivable

The balance of the Group's trade and bills receivable as at 31 December 2006 was HK\$1,272 million, up by 50.27% over that of HK\$847 million as at 31 December 2005. In terms of structure, however, trade receivables decreased by HK\$313 million, or 77.42%; bills receivable increased by HK\$738 million, or 166.73%, which was mainly caused by the issue of convertible bonds allowing fund sufficiency with no need to finance from bills discounting. Because collection of bills receivables is guaranteed by the banks, the risk in collecting bills receivables is low.

Trade and bills receivable turnover day(note) increased from 13 days in 2005 to 18 days in 2006.

*Note: Calculated on the basis of average trades and bills receivables balance as at the end of the reporting period divided by turnover, and multiplied by 365 days.*

### VII. Properties, Plants and Equipment

As at 31 December 2006, the balance of the Group's properties, plants and equipment was HK\$901 million, increasing by 24.02% over that of HK\$727 million as at 31 December 2005. This was mainly due to increased fixed assets arising from investment in the 0.3 million ton MAP project and 0.2 million ton ammonium and 0.2 million ton urea project at Sinochem Fuling.

## Management's Discussion and Analysis

### VIII. Investment Properties

As at 31 December 2006, the balance of the Group's investment properties was HK\$15 million, decreasing by 90.92% from that of HK\$160 million as at 31 December 2005. This was mainly due to the disposal of the Group's investment properties in Hong Kong.

### IX. Interests in Jointly Controlled Entities

As at 31 December 2006, the balance of the Group's interests in jointly controlled entities was HK\$382 million, increasing by 3.75% over that of HK\$368 million as at 31 December 2005. This was mainly caused by:

1. a reduction of HK\$43 million of interests in Yunnan Three Circle-Sinochem-Cargill Fertilizer Company Limited due to dividend payout;
2. an increase of HK\$41 million of interests arising from using the equity method of accounting, and
3. an exchange difference of HK\$13 million arising from revaluation of RMB.

### X. Available-for-Sale Investments

As at 31 December 2006, the balance of the Group's available-for-sale investments was HK\$290 million, while the figure as at 31 December 2005 was HK\$14 million. This was mainly attributable to original investments of HK\$241 million in purchase of shares of Luxi Chemical and Hualu Hengsheng, plus HK\$40 million arising from appreciation.

### XI. Prepayments and Other Receivable

As at 31 December 2006, the balance of the Group's prepayments and other receivable was HK\$1,336 million, up by 194.27% over that of HK\$454 million as at 31 December 2005. This was mainly due to the increased purchase of domestic fertilizers at the end of year 2006, which incurred an amount of HK\$949 million in prepayments. However, the goods paid for in this amount had not been delivered per the provisions of the purchase contracts as at 31 December 2006.

### XII. Long-Term Loans

As at 31 December 2006, the balance of the Group's long-term loans was HK\$363 million, up by 55.13% over that of HK\$234 million as at 31 December 2005. This was mainly caused by:

1. repayment of long-term loans of HK\$69 million; and
2. a long-term loan of HK\$200 million newly obtained and used for the 0.3 million ton DAP project and 0.2 million ton ammonium and 0.2 million ton urea project at Sinochem Fuling.

## Management's Discussion and Analysis

### XIII. Trade and Bills Payables

As at 31 December 2006, the balance of the Group's trade and bills payables was HK\$1,815 million, decreasing by 25.86% from that of HK\$2,448 million as at 31 December 2005. Specifically, the amount of trade payables remained the same level as at 31 December 2005, while the amount of bills payables decreased by HK\$598 million, which was the result of payment for goods purchased being made in telegraphic transfer instead of bills payables.

### XIV. Receipts in Advance and Other Payables

As at 31 December 2006, the balance of the Group's receipts in advance and other payables was HK\$939 million, increasing by 125.07% over that of HK\$417 million as at 31 December 2005. This was mainly attributable to an increase of HK\$574 million in receipts in advance by Sinochem Fertilizer Co. Ltd and its distribution network from the customers.

### XV. Convertible Bonds

The Company issued 130,000 zero coupon notes with face value of HK\$10,000 each on 7 August 2006. The convertible loan notes are denominated in Hong Kong dollars. The notes entitle the holders to convert them into ordinary shares of the Company on or after 22 August 2006 up to and including the close of business on 23 July 2011 or, if the notes shall have been called for redemption before the 7 August 2011 (maturity date), then up to the close of business on a date no later than seven business days prior to the date fixed for redemption at a conversion price of HK\$3.74 per ordinary share (subject to adjustment). If the notes have not been converted or early redeemed, they will be redeemed on the maturity date at 127.23% of the face value of the notes.

The Company may, on or at any time after 7 August 2009 and prior to 7 August 2011, redeem all, but not in part, of the notes at the early redemption amount (for each HK\$10,000 principal amount of the notes, is determined so that it represents for the noteholder a gross yield at 4.875% per annum, calculated on a semi-annual basis) subject to certain conditions being fulfilled. The note holders also have the right to require the Company to redeem all or in part of the notes at 115.55% of the face value on 7 August 2009.

The convertible loan notes contain two components with liability component stated at amortized cost and derivatives (conversion option, holder redemption option and issuer redemption option) stated at fair value. An issue cost of HK\$27,513,000 relating to the liability component is included into the fair value of liability component at the date of issue. The effective interest rate of the liability component is 6.82%.

As at 31 December 2006, an amount of HK\$33 million in interest to be paid on the convertible loan notes was recorded as finance cost for the reporting period.



## Management's Discussion and Analysis

### XVI. Other Financial Indicators

Earnings per share (EPS) for the twelve months ended 31 December 2006 was 15.43 HK cents, increasing by 6.49% over that of 14.49 HK cents for the corresponding period of 2005, which was mainly attributable to the growth of net profit in 2006. If the non-cash finance cost arising from the issue of convertible bonds readjusted, the EPS for year 2006 would be 15.99 HK cents, which was up by 10.35% over that of year 2005.

Return on equity (ROE) for the twelve months ended 31 December 2006 was 20.61%, decreasing by 1.82 percentage points over that of 22.43% for the corresponding period of 2005. This was mainly attributable to that the increase rate of net profit was lower than the increase rate of equity. In 2006 net profit rose by 14.99%, while equity increased by 25.14% thanks to RMB revaluation and investment appreciation.

The current ratio increased from 1.41 as at 31 December 2005 to 1.93 as at 31 December 2006, showing improved short-term solvency. The debt-to-equity ratio increased from 34.40% as at 31 December 2005 to 37.03% as at 31 December 2006.

**Table 2:**

	<b>2006</b>	2005
<b>Profitability</b>		
EPS (HK cents) (Note 1)	<b>15.43</b>	14.49
EPS (HK cents) (Note 2)	<b>15.99</b>	14.49
Return on equity (Note 3)	<b>20.61%</b>	22.43%
<b>Solvency</b>		
Current ratio (Note 4)	<b>1.93</b>	1.41
Debt-to-equity ratio (Note 5)	<b>37.03%</b>	34.40%

Note 1: Calculated on the basis of net profit for the reporting period (excluding minority interests) divided by weighted average number of shares for the reporting period.

Note 2: Calculated on the basis of net profit for the reporting period (excluding minority interests and non-cash finance cost arising from the issue of convertible bonds) divided by weighted average number of shares for the reporting period.

Note 3: Calculated on the basis of net profit for the reporting period (excluding minority interests) divided by total equity as at the end of the reporting period.

Note 4: Calculated on the basis of current assets divided by current liabilities as at the end of the reporting period.

Note 5: Calculated on the basis of total interest-bearing debt divided by total equity as at the end of the reporting period.

## Management's Discussion and Analysis

### XVII. Liquidity and Financial Resources

The Group's principal sources of financing included cash generated from operations and bank borrowings. All the financial resources were primarily used for the Group's trading and distribution, production, repayment of liabilities as they fall due and for related capital expenditures.

As at 31 December 2006, cash and cash equivalents of the Group were HK\$86 million, which was mainly denominated in RMB and US dollar.

Set out below is an analysis of long-term and short-term loans of the Group:

**Table 3:**

	<b>As at 31 December 2006 HK\$'000</b>	As at 31 December 2005 HK\$'000
Secured	<b>53,747</b>	126,744
Guaranteed	<b>19,906</b>	13,044
Unsecured	<b>388,617</b>	1,119,352
<b>Total</b>	<b>462,270</b>	1,259,140

The Group intended to meet its obligations for the above loans by using internal resources.

As at 31 December 2006, the Group had banking facilities of HK\$9,865 million, including US\$495 million, 6,070 million RMB, and HK\$5 million, dominated in respective currencies. The amount of banking facilities already used was HK\$2,291 million, and that of unused was HK\$7,574 million.

### XVIII. Operation and Financial Risks

The Group's major operation risks include: uncertainties of the impact of Chinese government policies on the fertilizer industry; price fluctuations of the fertilizer market; as well as uncertainties caused by government influence as shown in the 2006 potash contract negotiations.

The Group's financial risks include market risks (currency risk, fair value interest rate risk and price risk), credit risk and liquidity risk as well as cash flow interest rate risk.

### XIX. Contingent Liabilities

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

## Management's Discussion and Analysis

### XX. Capital Commitments

Table 4:

	<b>As at 31 December 2006 HK\$'000</b>	As at 31 December 2005 HK\$'000
<b>Assets under construction</b>		
Contracted but not provided for	<b>187,404</b>	71,922
Authorized but not contracted for	<b>21,655</b>	8,459
Subtotal	<b>209,059</b>	80,381
Investment in Yunnan Three-Circle Sinochem Fertilizer Company Limited	<b>139,345</b>	134,577
<b>Total</b>	<b>348,404</b>	214,958

### XXI. Major Investment

As at 31 December 2006, the Group's major investment amounted to HK\$538 million, including HK\$297 million invested in projects under construction at Sinochem Fuling, HK\$129 million in purchase of shares of Luxi Chemical, and HK\$112 million in purchase of shares of Hualu Hengsheng.