

## Management Discussion and Analysis

### Review of Business and Prospect

In 2006, the Group produced approximately 10,373 kg (equivalent to approximately 333,499 ounce) of gold including approximately 10,285 kg (equivalent to approximately 330,670 ounce) of gold bullion and approximately 492 kg (equivalent to approximately 15,818 ounce) of compound gold including intra-group sales of approximately 404 kg (equivalent to approximately 12,989 ounce) of compound gold, representing an increase of approximately 366 kg (equivalent to approximately 11,767 ounce) or 3.7% as compared with the previous year. The Group's turnover for 2006 was approximately RMB2,234,975,000, representing an increase of approximately 43.7% as compared with the previous year. The profit attributable to the Company's shareholders was approximately RMB219,836,000, representing an increase of approximately 42.2% as compared with the previous year. The Company's basic earnings per share was RMB0.29. In 2006, the Group achieved positive growth in both turnover and profit attributable to shareholders. The increase in profit was mainly due to the strong market demand as well as high product prices and effective control of production cost.

Given that raw materials accounted for over 80% of total production cost and in order to minimize the reliance of purchase of raw materials from outsiders, the Group intends to increase its self-produced gold output through acquisitions and expansion of mine operation, thereby uplifting the overall production and operation targets.

### 1. Mining Segment

#### *Turnover and production*

Our mining business mainly comprises the sales of gold concentrates and other derivative products, such as compound gold and lead concentrates. All gold concentrates are sold to the Group's smelting plants as intra-group sales, while other derivative products are sold to third party customers.

The following table sets forth the analysis on the production and sales volume of the mining segment by product category:

	Unit	2006		2005	
		Approximate production volume	Approximate sales volume	Approximate production volume	Approximate sales volume
Gold concentrates	Kg	1,728	1,712	1,443	1,484
Compound gold	Kg	492	492	616	708
From: Henan region		96	96	382	474
Xinjiang region		396	396	234	234
Total	Kg	2,220	2,204	2,059	2,192
Total	Ounce	71,375	70,861	66,198	70,474
Lead concentrates	Kg	72	72	257	257

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The Group's total turnover of the mining segment for 2006 was approximately RMB307,765,000, representing an increase of approximately 23.6% from approximately RMB248,905,000 in 2005. During the year, turnover of gold mines in Henan and Xinjiang represented approximately 79.8% and 20.2% of the total turnover of the mining segment respectively. The production volume of compound gold decreased by approximately 124 kg to approximately 492 kg while the production volume of gold concentrates increased by approximately 285 kg to approximately 1,728 kg, because since July 2005, there has been a change in technology of the processing facilities of our gold mines in Henan. As a result of the change in technology, we increased our production in gold concentrates and decreased our production in compound gold. The change was aimed to increase the gold content of our gold concentrates and boost internal sales of gold concentrates to our smelting plant. Apart from gold concentrates and compound gold, the Group's mining segment also produced lead concentrates. Lead concentrates are another type of gold concentrates which contain lead and are sold to third party customers. Production of lead concentrates in this year was approximately 72 kg.

### **Segment results**

The Group's results of the mining segment for 2006 was approximately RMB66,670,000, representing a decrease of approximately 6.0% from approximately RMB70,906,000 in 2005. The segment result to segment turnover ratio of the Group's mining segment for 2006 was approximately 21.7%, marking a decrease of approximately 6.8% from approximately 28.5% in 2005.

### **Capital expenditures**

As at 31 December 2006, the Group's capital expenditure was approximately RMB303,442,000, representing an increase of approximately 272.1% from approximately RMB81,553,000 in 2005.

Our principal capital expenditures relate to the provisions of construction of gold mines, purchase of mining rights and acquisition of mining corporations.

### **Prospect**

The Group is expecting an increase in production capacity, gold reserves and resources through the expansion of production scale and improvement of production facilities in both Duolanasayi Gold Mine and Tuokuzibayi Gold Mine located in Xinjiang which are expected to be completed in the fourth quarter of 2007. The Group's processing capacity will increase from 2,400 tonnes per day currently to 3,000 tonnes per day.

With our continuous exploration and acquisitions of gold mines, our gold reserves and resources are increasing. Group's objective for 2007 is to increase our gold reserves and resources by exploring the in-depth deposits of Qiangma Gold Mine and Yinxin Gold Mine in the Xiaoqinling Region and continuously engaging in mining and gold production process in the gold mines located in Henan Nanyang Xingyuan Gold Mine, Jiangxi Mingxin Gold Mine, Shangrao County Jintian Industrial Co. Ltd. Gold Mine, Xinjiang Duolanasayi Gold Mine, Tuokuzibayi Gold Mine, Kaqia Gold Mine, Chifeng City Zhengji Gold Mine and Chifeng Jinchan Operating Mine of Inner Mongolia.

## 2. Smelting Segment

Our smelting plant is situated in Henan Province, and is capable of processing gold, silver, copper and sulphur. Its main products include gold bullion, silver, copper products and sulphuric acid. The following table sets forth the analysis on the production and sales volume of the smelting segment by product category:

Product	Unit	2006		2005	
		Approximate production volume	Approximate sales volume	Approximate production volume	Approximate sales volume
Gold bullion	Kg	10,285	10,426	9,391	9,287
	Ounce	330,670	335,203	301,927	298,584
Silver	Kg	29,175	28,151	33,331	32,750
	Ounce	937,997	905,074	1,071,615	1,052,935
Copper products	Tonne	8,991	9,543	9,994	7,746
Sulphuric acid	Tonne	158,016	160,799	151,212	145,827

### **Turnover and production**

The Group's total turnover in the smelting segment for 2006 was approximately RMB2,222,524,000, representing an increase of approximately 53.2% from approximately RMB1,450,846,000 for the year of 2005. Such increase was principally attributable to the 48.0% increase in the sales of gold bullion as a result of an approximate 31.9% increase in selling price of gold bullion. Also, the unit selling price, sales volume and total sales amount of copper products had increased by approximately 53.2%, 23.2% and 88.7% respectively.

In 2006, the Group's smelting plant processed approximately 700 tonnes of gold concentrates per day, and the utilisation rate for production was approximately 96.7%. This resulted in a slight increase in the Group's production volume. During the period, the gold recovery rate was approximately 96.43%, the silver recovery rate was approximately 76.12% and the copper recovery rate was approximately 93.39%. All recovery rates continued to remain at a high level.

### **Segment results**

Our smelting segment results for 2006 was approximately RMB316,873,000 in total, representing an approximate 21.1% increase from approximately RMB261,755,000 for the year of 2005. The segment results to segment turnover ratio of our smelting business for 2006 was approximately 14.3%, decreasing by approximately 3.7% from approximately 18.0% in 2005. The average selling price of gold bullion increased by approximately 31.9% to approximately RMB155.1 per gram (equivalent to approximately USD600.8 per ounce).

### **Capital expenditures**

As at 31 December 2006, the capital expenditure of the Group was approximately RMB45,318,000, an increase of approximately 53.5% from approximately RMB29,520,000 in 2005.

Our principal capital expenditures relate to the provisions of smelting construction work, purchase of equipment with regard to its development and expansion projects, and upgrading of production equipment.

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### **Prospect**

Riding on the surging gold prices and through advanced technology and production efficiency, the Group's smelting segment was able to deliver respectable results in both production and sales volume and fulfilled all major production and operation targets.

The Group expects to maintain a high recovery rate by securing the supply of gold concentrates for the smelting segment.

### Financial Condition

#### 1. Combined Operating Results

##### **Turnover**

The following table sets out the Group's sales breakdown by products:

	2006			2005		
	Amount RMB'000	Sales volume kg/tonne	Unit price RMB per kg/tonne	Amount RMB'000	Sales volume kg/tonne	Unit price RMB per kg/tonne
Gold bullion	1,617,183	10,426 kg	155,111	1,092,341	9,287 kg	117,620
Compound gold	13,812	88 kg	156,955	82,637	708 kg	116,719
From: Henan region	-	- kg	-	54,235	474 kg	114,420
Xinjiang region	13,812	88 kg	156,955	28,402	234 kg	121,376
Silver	80,846	28,151 kg	2,872	58,296	32,750 kg	1,780
Copper products	488,505	9,543 tonne	51,190	258,859	7,746 tonne	33,418
Sulphuric acid	32,862	160,799 tonne	204	37,581	145,827 tonne	258
Lead concentrates	9,069	72 kg	125,958	29,518	257 kg	114,856
Turnover before sales tax	2,242,277			1,559,232		
Less: Sales tax	(7,302)			(3,528)		
	<u>2,234,975</u>			<u>1,555,704</u>		

The Group's turnover for 2006 was approximately RMB2,234,975,000, representing an approximate 43.7% increase as compared with the previous year. Such increase was chiefly attributable to the increase of approximately 48.0% in the sales of gold bullion, as a result of the increases in our average selling price and quantity of gold bullion sold of approximately 31.9% and 12.3% respectively during the year.

The increase in turnover during the year was also due to the increase in the sale of copper products by approximately 88.7%, that is, from approximately RMB258,859,000 for 2005 to approximately RMB488,505,000 for 2006, of which the average price and sales volume of copper products increased by 53.2% and 23.2% respectively.

#### **Cost of sales**

The Group's cost of sales for 2006 was approximately RMB1,792,220,000, representing an approximate 45.1% increase from approximately RMB1,235,479,000 for 2005. Such increase was principally attributable to the increase of 48.5% in the cost of raw materials, especially gold concentrates, to RMB1,499,522,000 as a result of the increase in production capacity, the growth of purchase volume and the increase in gold price. Owing to the rise in gold price, the unit purchase price of gold concentrates increased by approximately 37.6%, that is, from approximately RMB99,580 per kg in 2005 to RMB137,010 per kg in 2006.

#### **Gross profit and gross profit margin**

The Group's gross profit and gross profit margin for 2006 were approximately RMB442,755,000 and approximately 19.8% respectively, representing an increase of approximately 38.3% and a decrease of 0.8% respectively as compared to 2005.

#### **Other revenue**

The Group's other revenue for 2006 was approximately RMB76,290,000, representing an approximate 547.8% increase as compared with the previous year. Such change was principally attributable to an increase in bank interest income amounted to RMB64,138,000.

#### **Other net loss**

The Group's other net loss for 2006 was approximately RMB26,718,000, representing an increase of 2,227.4% as compared with the previous year. Such increase was mainly attributable to the exchange loss of RMB25,689,000 arising from the one-off initial public offering of the Company during the year.

#### **Selling and distribution expenses**

The Group's selling and distribution expenses for 2006 were approximately RMB15,545,000, representing an increase of approximately 33.2% as compared with the previous year. Such increase was principally attributable to increase of transportation cost as a result of production volume increase.

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### **Administrative expenses and other operating expenses**

The Group's administrative expenses and other operating expenses for 2006 were approximately RMB108,228,000, representing an approximate 51.8% increase from approximately RMB71,299,000 for 2005. The increase was chiefly attributable to the addition gold mines in Xinjiang and Jiangxi.

### **Finance costs**

The Group's finance costs for 2006 was approximately RMB31,213,000, representing an approximate 35.2% increase from approximately RMB23,085,000 for 2005. The increase was principally attributable to the bank and other borrowings which increased by approximately RMB532,850,000 in net amount to RMB938,270,000 for the year ended 31 December 2006.

### **Income tax**

The PRC statutory income tax rate is 33%. The Group was subject to an effective income tax rate (being total income tax divided by the profit before taxation) of approximately 34.5% for 2006, representing an increase of approximately 2.7% from the effective income tax rate of 31.8% for 2005. The increase was principally attributable to the approximately RMB2,135,000 tax credit additionally granted by the local tax authority for purchasing domestically-produced machinery and equipment and the decrease in tax of RMB1,360,000 arising from the increase in non-taxable revenue.

### **Profit attributable to the Company's equity holders**

The Group's profit attributable to our equity holders for 2006 was approximately RMB219,836,000 representing an approximate 42.2% increase from approximately RMB154,584,000 for 2005. The net profit margin for 2006 was approximately 9.8%, represent a decrease of 0.1% to that of approximately 9.9% in 2005. The Company's basic earning per share was RMB0.29. It was recommended for the payment of a dividend of RMB0.08 per share.

## **2. Liquidity and capital resources**

The Group's primary sources of working capital and long-term funds have been cash flows from operation and borrowings. The Group's primary use of funds has been capital expenditures, operating activities and repayment of borrowings.

Net cash inflow from:

	<b>2006</b>	2005
	<b>RMB'000</b>	RMB'000
Operating activities	<b>173,212</b>	63,379
Investing activities	<b>(1,250,158)</b>	(126,600)
Financing activities	<b>1,306,350</b>	104,576
Net cash inflow	<b>229,404</b>	41,355

### **Cash flows and working capital**

The Group's cash and cash equivalents increased by approximately RMB229,404,000, that is, from approximately RMB117,861,000 at 31 December 2005 to approximately RMB347,265,000 at 31 December 2006. Such increase was primarily due to cash inflow arising from operating and financing activities offset by an increase in expenses for investing activities.

***Net cash flows from operating activities***

The Group's principal source of liquidity is cash generated from operating activities. Net cash inflow from operating activities increased from approximately RMB63,379,000 in 2005 to approximately RMB173,212,000 in 2006. This was mainly due to an increase in profit before tax of approximately 48.7% arising from rises in product prices and sales volume.

***Net cash flows used in investing activities***

The Group's net cash flows used in investing activities were primarily affected by purchase of property, plant and equipment and construction in progress. Net cash spent in investing activities for 2006 was RMB1,250,158,000. This was mainly due to restricted deposit of approximately RMB526,439,000 and investment deposit of approximately RMB460,162,000.

***Net cash flows from financing activities***

The Group's net cash flow from financing activities was primarily affected by issuance of new shares during the year and new bank loans. Net cash flow from financing activities was approximately RMB1,306,350,000. This was mainly due to the net proceeds of approximately RMB865,379,000 from issuance of new shares in 2006 and increase of approximately RMB532,850,000 in the bank loans (which offset repayment).

**3. Borrowings**

As at 31 December 2006, the Group had a total of outstanding bank loans and other borrowings of approximately RMB938,270,000 of which approximately RMB935,000,000 was repayable within one year while approximately RMB3,270,000 was repayable after five years. The gearing ratio as at 31 December 2006 was 33.8% which was based on total borrowing divided by total assets value.

**4. Security**

As at 31 December 2006, our bank loans of approximately RMB50,000,000 in aggregate were secured by properties with an aggregate net book value of approximately RMB38,275,000 and plant and equipment with an aggregate net book value of approximately RMB43,337,000.

**5. Acquisition**

On 30 June 2006, the Group completed the acquisition of 100% equity interests in Shangrao County Jintian Industrial Company Limited, a mining company which owns an exploration right in Jiangxi Province, at a cash consideration of RMB7,120,000. On the same date, the Group has further injected capital of RMB37,500,000 to the company.

On 2 August 2006, the Group entered into an agreement to acquire 80% equity interests in Chi Feng City Zheng Ji Mining Limited Company, a mining company which owns an exploration right in Inner Mongolia Autonomous Region, at a cash consideration of RMB68,640,000.

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According to a valuation report issued by an independent certified mining rights valuer, approximately 16.8 tonnes of gold resource was identified in the area covered by the exploration right. The Group's geographical area of operation was thus expanded to Inner Mongolia Autonomous Region.

On 12 December 2006, the Group completed the acquisition of 100% equity interest in Wuyuan Country Jincheng Mining Company Limited at a consideration of RMB12,800,000.

### 6. Market risks

The Group are exposed to various types of market risks, including fluctuations in gold prices, changes in interest rates and foreign exchange rates.

#### ***Gold price and other commodities price risk***

The Group's turnover and profit during the year are affected by fluctuations in the gold prices and other commodities price as all of our turnover and profit are generated within the PRC. We do not enter into commodity derivative instruments or futures to hedge any potential price fluctuations of gold and other commodities or for trading purposes. Therefore, fluctuations in the prices of gold and other commodities may have a significant effect on the Group's turnover and profit.

#### ***Interest rate***

The Group is exposed to risks resulting from fluctuations in interest rates on our debt. The Group undertakes debt obligations for supporting general corporate purposes, including capital expenditure and working capital needs. Our bank loans bear interest rates that are subject to adjustment made by our lenders in accordance with changes of the relevant People's Bank of China ("PBOC") regulations. If the PBOC increases interest rates, our finance cost will be increased. In addition, to the extent that we may need to raise debt financing in the future, upward fluctuations in interest rates will increase the cost of new debt.

#### ***Exchange rate risk***

The Group's transactions are all denominated in Renminbi. Fluctuations in exchange rates may affect the international and domestic gold price, which may impact our results of operation. The Renminbi is not a freely convertible currency and the currency would fluctuate against a basket of currencies. The PRC government may take further actions and implement new measures on free trade of Renminbi. Fluctuations in exchange rates may adversely affect the value of our net assets, earnings and any dividends we declare when such are being converted to Hong Kong dollars.



**7. Contractual obligations**

As at 31 December 2006, capital commitments, including the construction costs not provided for in the financial statement, were approximately RMB294,403,000, representing an increase of approximately RMB11,761,000 from approximately RMB282,642,000 as at 31 December 2005.

As at 31 December 2006, our total future minimum lease payments under noncancellable operating leases amounted to approximately RMB2,487,000, of which approximately RMB695,000 was payable within one year, approximately RMB1,064,000 was payable after one year but within five years, and approximately RMB728,000 was payable after five years.

**8. Contingent liabilities**

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

**9. Human resources**

During 2006, the average number of employees of the Group was 2,718. Being one of the largest integrated gold producing companies based in PRC, the Company highly treasures its human resources and offers competitive remuneration to employees and provides employees with training programs. In the first half of 2006, the Group has paid out cash bonus to most employees of the Group in recognition of their performance in 2005.