

## INDUSTRY REVIEW

Year 2004 was a supplier's market in the zirconium industry in the PRC. The zirconium market was affected by the continued short supply of the raw material zircon sand and its surging price. In the last quarter of 2004, the shortage problem was worsened by the fact that the world's leading zircon sand supplier in Australia has terminated the relationship with its sole distributor in the PRC, upon which its normal zircon sand supply to the PRC market has been stopped for a certain period of time. Prices of other raw materials (including nickel and cobalt) were in an upward trend during the first half year of 2004 and remained at a relatively high level in the second half year. These factors, coupled with the shortage in supply and increase in prices of electricity and coal in the Eastern part of the PRC, had led to an escalation in the production costs of zirconium chemicals and hence a negative growth on the gross profit margins. Despite the significant cost pressure, the growth in the PRC zirconium market sustained in 2004. Zirconium chemicals production continued to be largely dominated by the PRC, particularly with respect to the production of zirconium oxychloride.

On the global basis, strong market demand for zirconium chemicals was mainly driven by the increase in the uses of zirconium downstream products. It will sustain continuous growth as the technology advances across a diversified spectrum of industries. In particular, advanced and structural ceramics is expected to be the fastest growing sector as a result of the rapid development of the telecommunication industry. Applications in the telecommunication industry, including optic-fibre technology and mobile phones, and in solid oxide fuel cell, will potentially boost the demand for specific high purity zirconium compounds.

In the PRC, certain small scale zirconium manufacturers temporarily suspended operations during the year as a result of their failure in obtaining stable supply of zircon sand and electricity. Under the macro economic austerity measures implemented by the PRC government, the banks continued to adopt stringent credit policies. Given its leading position in the PRC zirconium industry, its large production scale, better cost structure and good relationship with leading zircon sand suppliers, the Group considers the current environment to be a good opportunity for further enlargement of its market share in both the domestic and overseas market.

## BUSINESS REVIEW

A few developments for the Group were noted in the year. In response to the shortage in zircon sand supply, the Group has further enhanced its zirconium products mix by shifting to higher margin downstream products. This strategy was proved to be correct in that the Group achieved relatively good revenue growth despite the negative effect of the tight supply of zircon sand in current year.

In January 2004, the Group established Yixing Better Batteries Company Limited, a wholly-owned subsidiary in the PRC specialised in the manufacture and sale of NiMH, NiCd and Li-ion batteries. Adding to the existing zirconium compounds business and new energy materials business, the Group expected to develop the rechargeable batteries business into its third largest segment in the next few years. Leveraging on its technical strength in zirconium industry, the Group is also engaged in the related electronic ceramic products business, the products of which include PTC chips and components, electric heating tubes and zirconium tiles.



# MANAGEMENT DISCUSSION AND ANALYSIS

(Continued)

In addition, the production capacity of new energy materials was expanded during the year to meet the rising demand from the customers. Currently, the Group has secured various local and overseas enterprises, including Wuxi Matsushita Battery Co., Ltd. of Panasonic Group in Japan, as its major customers. Such renowned international customer groups are conducive to the long-term development of the business.

As in the past years, the Group is committed to improving operating efficiency and reducing operating costs. Given the shortage in the electricity supply in the PRC, the Group acquired a thermal power plant in Yixing in April 2004. This helps ensuring the substantial, continuous and stable supply of electricity and steam for the increasing demand from the Group's expanding production scale. Thus, the Group was totally unaffected by the power shortage problem influencing the overall manufacturing industries in the PRC.

## FINANCIAL REVIEW

### Turnover Analysis

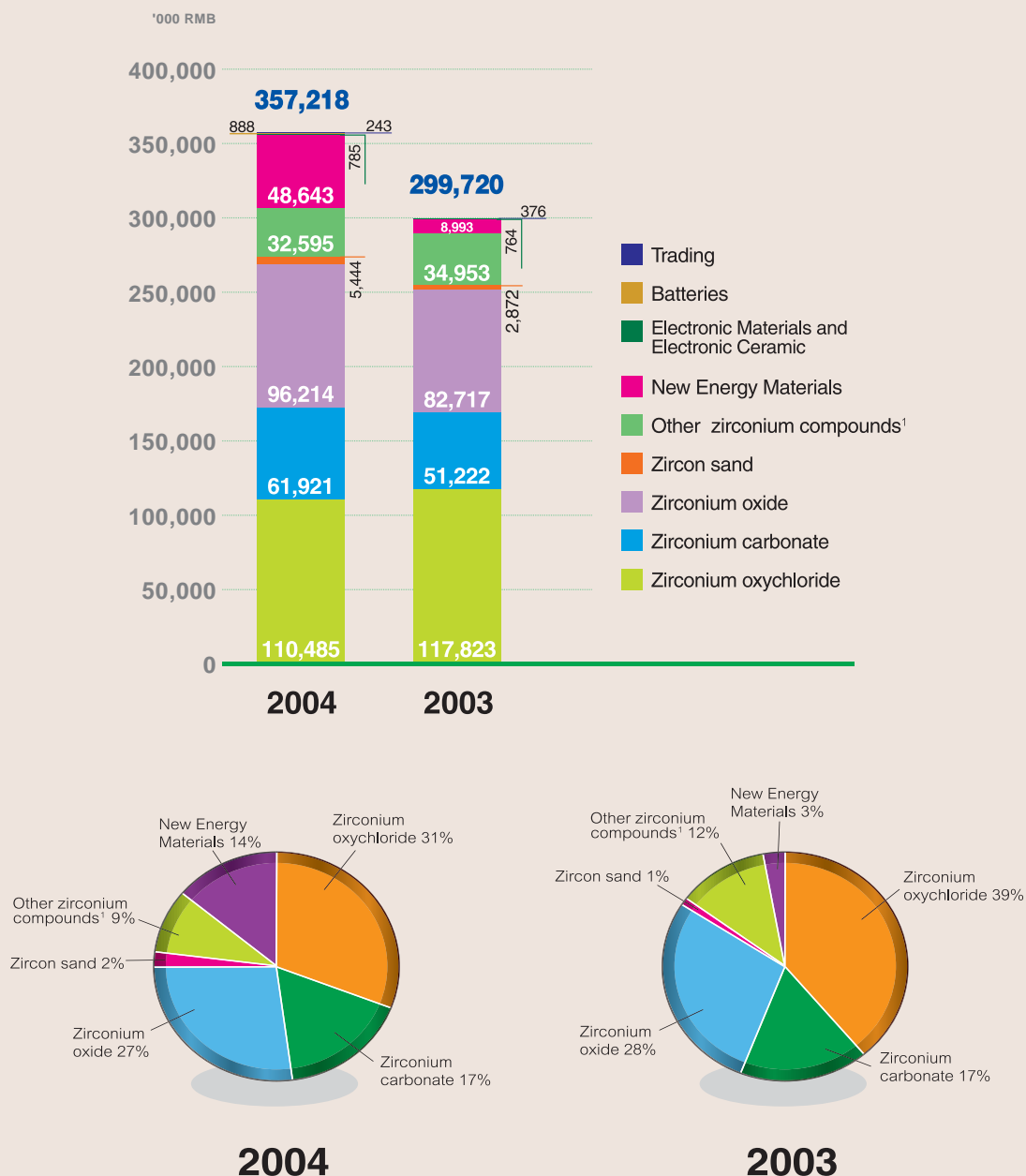
For the year ended 31 December 2004 (the "Year"), the Group achieved a 19% growth in its turnover from RMB299,720,000 in 2003 to RMB357,218,000. The manufacture and sale of zirconium chemicals remained as the major revenue source for the Group, contributed to 86% of the Group's turnover for the Year. As aforementioned, the Group has enhanced the product mix such that the proportion of sales contributed by low-end zirconium products, such as zirconium oxychloride, declined during the Year. The effect of the Group's revenue base expansion in 2003 extended to 2004. Sales of new energy materials increased to RMB48,643,000 in the Year, accounted for 14% of the Group's total turnover. The Board is grateful to see that the Group's measures in opening up new revenue streams were proved to be effective and successful.



Production Workshop of New Energy Materials

## Turnover analysis by product category

The charts below are a comparison of the Group's turnover by product category for the year ended 31 December 2003 and 31 December 2004 and the proportion of turnover for the relevant product categories:



Note 1: "Other zirconium compounds" included potassium zirconium hexafluoride, zirconium sulphate, zirconium acetate, zirconium silicate and ammonium zirconium hexafluoride, etc.



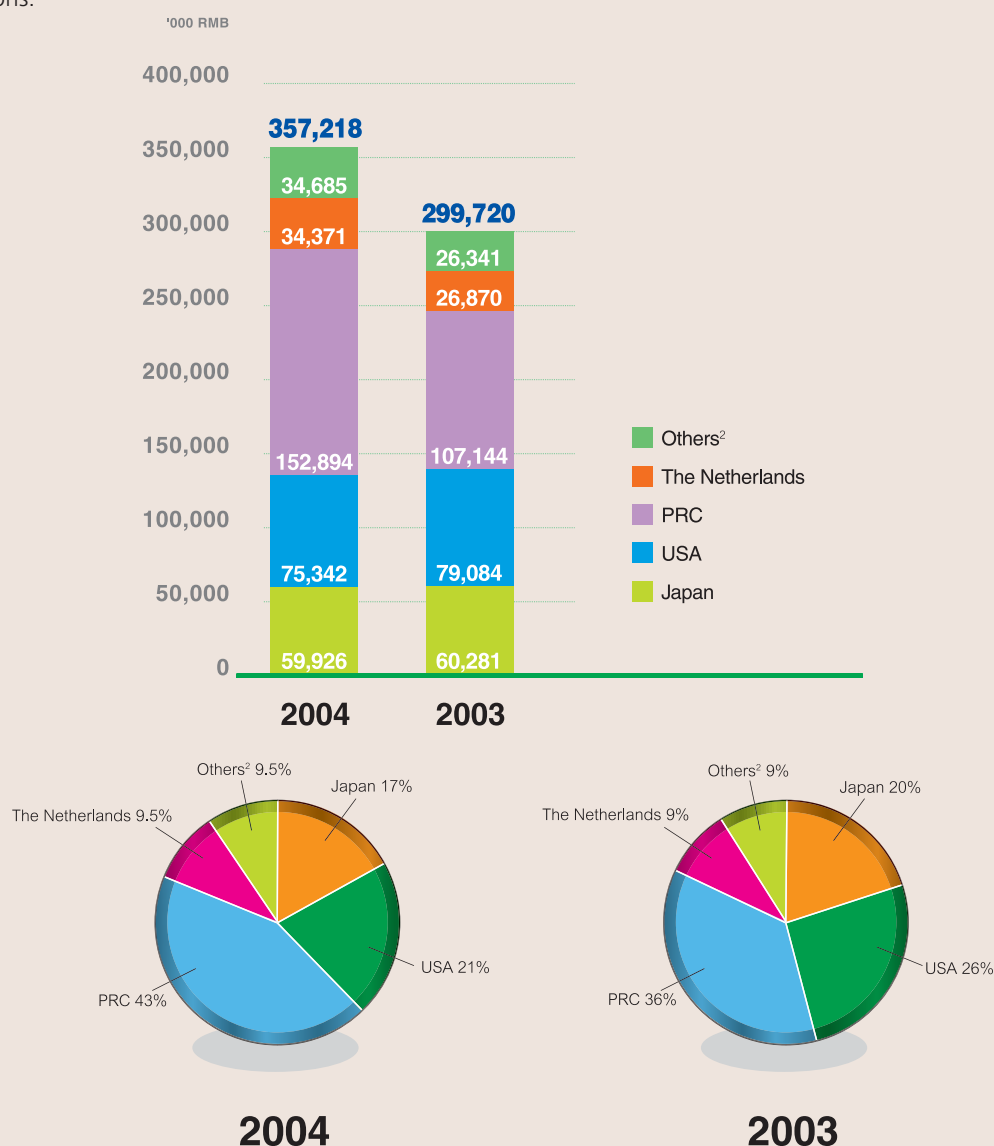
# MANAGEMENT DISCUSSION AND ANALYSIS

(Continued)

Total sales of zirconium products increased by RMB16,939,000 or 6% over prior year. This was mainly attributable by the higher sales achieved in zirconium carbonate and various types of zirconium oxides, including super-fine and nanometer grade zirconium oxides which were considered as high value-added products in the market. Total turnover from new energy materials segment was RMB48,643,000, accounted for 14% of the Group's total revenue for the Year. Although sales of new energy materials in 2003 and 2004 were not directly comparable as this new segment only commenced operation in June 2003, we are grateful to see this new segment gaining considerable market share during the Year. With continuous products enhancement and market development efforts, we fully expect the new energy materials products to bring even more valuable returns to the Group in the not too distant future.

## Turnover analysis by geographical region

The following charts presented a year-to-year comparison of the 2003 and 2004 turnover in terms of geographical locations:



Note 2: "Others" included the United Kingdom, Germany, Korea, India, Austria, Lithuania, South Africa, Columbia, Brazil, Turkey, New Zealand and Italy, etc.

Domestic sales of the Group's products increased over the year from 36% to 43% of the total turnover mainly due to the following two reasons:

- (i) more production processes with applications of zirconium chemicals and new energy materials were shifted to the PRC, in particular, certain overseas customers moved their production facilities to the PRC and hence the corresponding portion of export sales became domestic sales; and
- (ii) the continuous development of the PRC economy help stimulating the domestic demand for zirconium chemicals and new energy materials.

In fact, the decrease in export sales was mainly resulted from the shifting of production processes to the PRC as aforementioned. The Group's continued commitment in producing high quality products at reasonable prices has entitled it to enjoy the loyalty from most overseas customers. In particular, the Group has maintained a good business relationship with its customers in Japan, Europe and the US for 26 years, 15 years and 14 years, respectively. This evidenced the recognition of and the confidence in the Group's product quality in the global market.

## Gross Profit and Gross Margin

Gross profit for the Year increased slightly by 4% to RMB102,158,000. The gross profit margin dropped from 33% in 2003 to 29% in 2004. This was mainly attributable to the increase in the costs of various raw materials, including zircon sand, nickel, cobalt and coal. Yet the Group was able to shift part of the cost increment to the customers through the adjustment on product prices, hence minimised the effect on its profit margins.

## Capital Expenditure

The capital expenditures for the year ended 31 December 2004 and 2003 were approximately RMB164,514,000 and RMB75,410,000, respectively. There was an increase of RMB89,104,000 or 118% in capital expenditure in the Year mainly because of the Group's acquisition of a power plant, the establishment of the batteries plant and the expansion of the new energy materials production capacities during the Year.

## Liquidity and Financial Resources

As at 31 December 2004, the Group's cash and bank balances were approximately RMB114,562,000 (2003: RMB139,665,000). The Group continued to maintain a strong and healthy financial structure. The Group had no short-term or long-term borrowings as at the end of year 2004 and 2003.

The average turnover of the Group's accounts receivable was approximately 32 days, same as prior year. Notwithstanding the longer credit period normally granted to the customers in new energy materials and batteries market, the Group continued with its tight credit control policy and maintained the accounts receivable turnover at a healthy level.

Inventory turnover days increased from 30 days for the year ended 31 December 2003 to 36 days for the year ended 31 December 2004. Such increase was mainly due to the following reasons:

- (i) increase in year-end inventories level as at 31 December 2004, resulted from the expansion of zirconium's production scale and operations of new segments; and
- (ii) increase in raw materials inventories, in response to the volatile market of various raw materials.



Electric Heating Tubes Workshop (1)



Electric Heating Tubes Workshop (2)

## Exposure to Foreign Exchange Risk

The Group's business transactions are mainly carried out in Hong Kong dollars, Renminbi and US dollars and given the exchange rates between these currencies are less volatile, its exposure to exchange risk is insignificant. It is the Group's policy that it will not engage in any speculative activities. During the Year, the Group has not engaged in any hedging transactions.

## Contingent Liabilities

As at 31 December 2004, the Group had no contingent liabilities.

## Pledge of Assets

As at 31 December 2004, the Group did not pledge any assets (2003: bank deposit of RMB125,000) as securities for the banking facilities granted by its bankers.

## Human Resources

As at 31 December 2004, the Group had a total of approximately 720 employees (2003: 517 employees). Total staff costs (including directors' emoluments) for the Year was approximately RMB17,124,000 (2003: RMB14,774,000), representing 5% of the Group's turnover (2003: 5%). Employees were remunerated based on their performance, experience and prevailing industry practice. Bonuses and rewards might also be awarded based on individual staff performance and in accordance with the Group's overall remuneration policies. The Group's management reviewed the remuneration policies and packages on a regular basis.