MANAGEMENT DISCUSSION AND ANALYSIS

INDUSTRY REVIEW

Under the government's macroeconomic regulation and control, the PRC economy continued to grow steadily and rapidly in 2005. Domestic demand for zirconium chemical products remains buoyant. With the gradual migration of the production process of various industries, such as paper industry and man-made diamonds (namely cubical zirconia) industry, into the PRC, it is expected that the domestic market for zirconium chemicals will expand further in the coming years. Another demand growth factor is expected to be coming from the nuclear power industry. This is also indirectly driven by the rapid economic development in the PRC, which led to severe power shortage and brownouts in many PRC cities. Thus the PRC government is planning for a fivefold increase in its nuclear generating capacity by 2020, which means the country will need to build more than 20 nuclear power plants. Being a part of the supply chain in the nuclear power equipment, the zirconium chemicals producers consider such development as a good prospect for the expansion of the market for their products.

However, the persistent surging of zircon price throughout the year has increased the cost of production remarkably. As a result, profit margin in zirconium chemicals industry was squeezed to a certain extent as compared to that for the previous two years. The challenge that we have is that the supply of zircon has been somewhat constrained, not just because of the delay of certain new zircon mining projects, but also by declining production of some of the existing zircon producers. It is anticipated that the shortage of zircon in the global market will remain tense for 2006, and probably into 2007 as well. Certain industry specialists forecasted that the high zircon price will sustain through 2007 and will not decline until 2008. This certainly exerts further cost pressure to the zirconium chemicals industry.

BUSINESS REVIEW

Notwithstanding the good market for zirconium chemicals in 2005, the expansion of the Company's zirconium business was somewhat constrained by the tight supply of zircon. At the beginning of the year, the Company has reached an annual supply agreement with a leading zircon producer which, to a certain extent, reduced the effect of the volatile zircon supply and price on the Company's business. Furthermore, building on prior year's experience, the Company continued to enhance its product structure by shifting more resources and capacity to high end products. This resulted in another year of revenue growth despite the unfavorable factor on the supply side. The surging price of raw materials not only affected the zirconium business but also brought unfavorable effect to the new energy materials segment. Continuously rising prices of nickel and cobalt led to an erosion of the profit margin in this segment. The management has adopted a strategy to reduce the supply to lower margin customers although this would result in a revenue growth at a rate lower than previously planned. In the long run, the management will flexibly adjust the production plan of new energy materials in order to achieve a revenue growth with reasonable profitability.

MANAGEMENT DISCUSSION AND ANALYSIS

Battery business established in last year began the commercialised production in 2005. As in the start-up stage of all other businesses, the battery segment achieved a turnover growth while making a negative contribution to the Group's profit. However, the management is glad to report that the Company has successfully developed the NiMH batteries with zirconium additive for application under high temperature environment. This new technology has passed the state level examination and has also completed the CE and UL certification for launching of the new products to the European and US markets. The management expects that the commercialisation of this new type of battery will contribute positively to both the revenue and profit of the battery business.

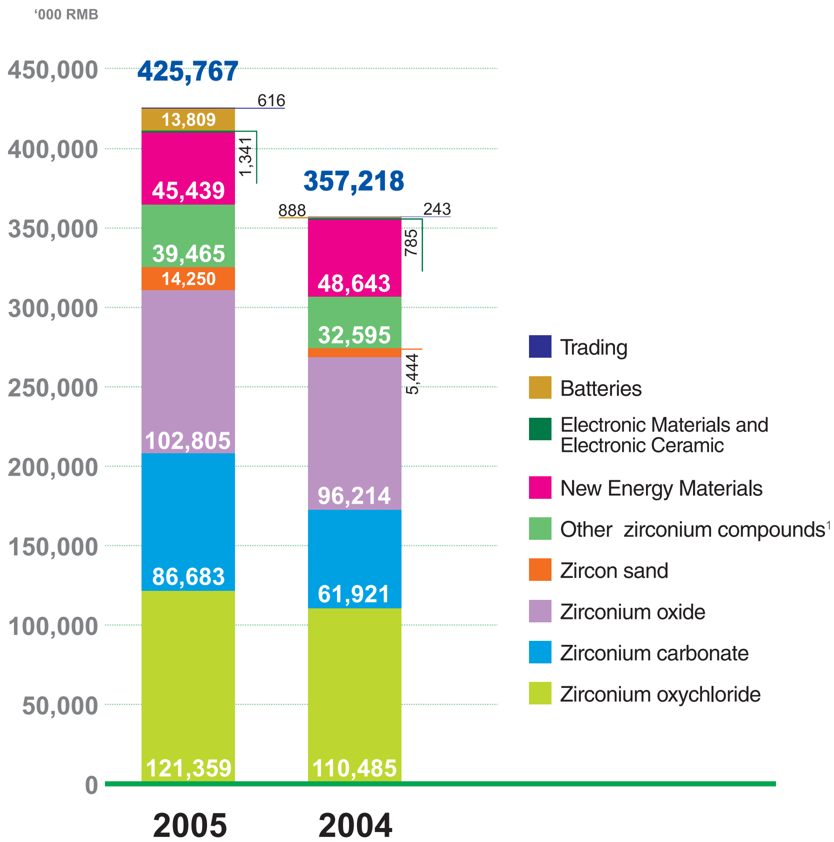
FINANCIAL REVIEW

Turnover Analysis

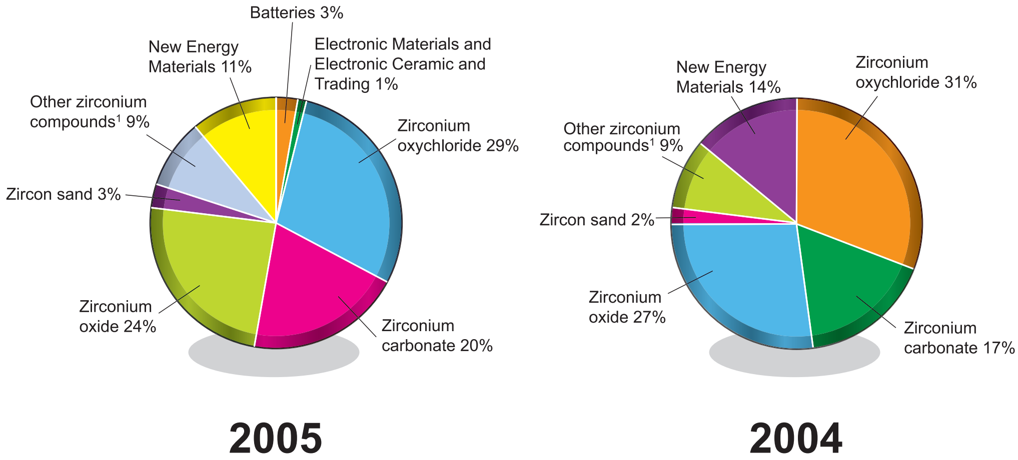
For the year ended 31 December 2005 (the "Year"), the Group reported a total turnover of RMB425,767,000, represented a year-to-year growth of 19%. The largest segment, zirconium chemicals, contributed to 85% of total turnover, while the new energy materials and battery business contributed 11% and 3%, respectively. Notwithstanding that the Group has successfully opened up new revenue streams, zirconium chemicals business remained as the main focus of the Group's development.

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 2004 and 31 December 2005 and the proportion of turnover for the relevant product categories:



MANAGEMENT DISCUSSION AND ANALYSIS



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

Total sales of zirconium chemicals increased by 19% or RMB57,903,000 as compared to prior year. This was mainly resulted from the further enhancement of product mix in the Year, being reflected in the lower percentage of sales contributed by zirconium oxychloride and higher sales of zirconium oxide as well as zirconium carbonate.

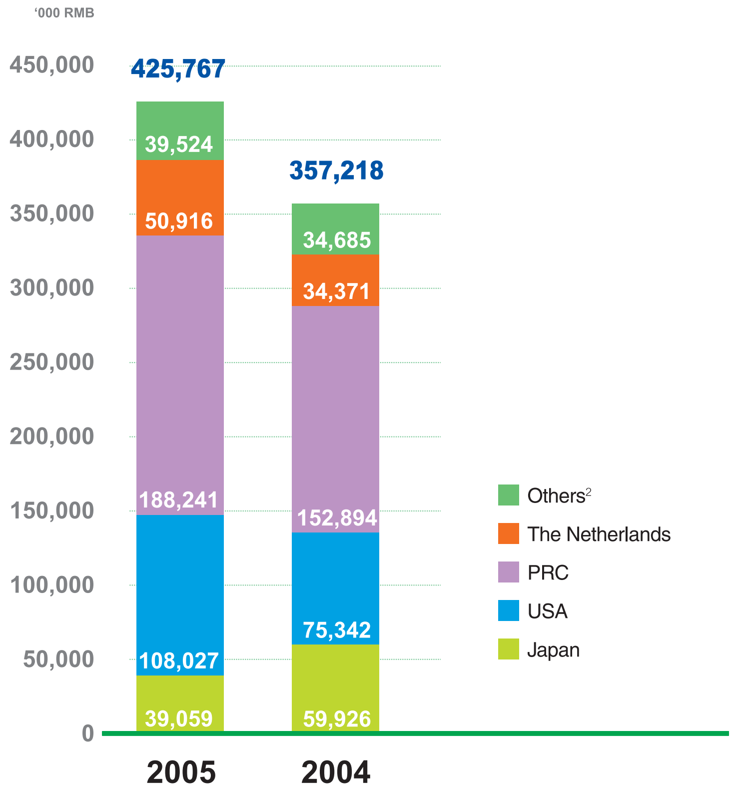
Total turnover of new energy materials was RMB45,439,000, represented a 7% drop from last year. During the Year, the management flexibly adjusted downwards the production and sales plan of new energy materials so as to constrain the negative effect of the rising raw materials prices on the overall profitability of the Group. The Company's strategy is to maintain a stable market share with a view to achieving a reasonable profit margin.

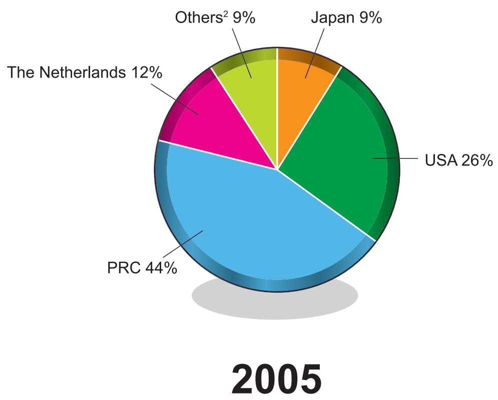
Battery segment reported a turnover of RMB13,809,000 in the Year, represented 3% of the Group's total turnover.

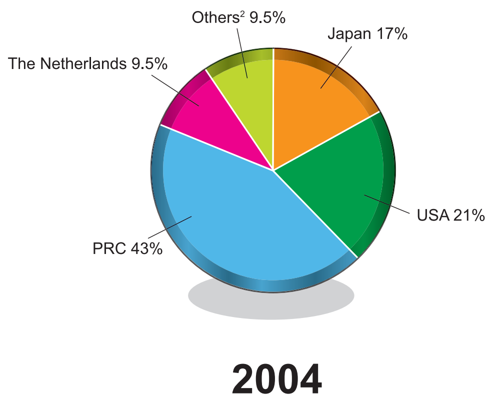
MANAGEMENT DISCUSSION AND ANALYSIS

Turnover analysis by geographical region

The following charts presented a year-to-year comparison of the 2004 and 2005 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 for the Year was approximately RMB188,241,000, represented 44% of total turnover or a 23% increase from prior year. The increment was partly contributed by zirconium chemicals sale, and to a certain extent by the sale of all new energy materials and batteries in the domestic market. Sales to Japan dropped by 35% to RMB39,059,000, whereas the sales to the Netherlands and US markets grew remarkably by 48% and 43%, respectively.

MANAGEMENT DISCUSSION AND ANALYSIS

Gross Profit and Gross Margin

Gross profit for the Year increased by 4%, from RMB102,158,000 to RMB106,115,000. Increase in sales of batteries and new energy materials made a negative contribution to the gross margin, which led to a drop from 29% in 2004 to 25% in 2005. The continuous rise in raw materials prices and the production in the new segments at a level below full capacity led to the increase in the production costs. Excluding the effect of the new segments, average gross margin of zirconium chemical products was relatively stable in 2005 and remained at a level similar to prior year.

Capital Expenditure

The capital expenditures for the year ended 31 December 2005 and 2004 were approximately RMB39,652,000 and RMB164,514,000, respectively. Capital expenditure dropped by 76% in 2005 mainly because most of the large scale construction and capital expansion projects had been completed in 2004.

Liquidity and Financial Resources

The Group continued to be cash positive in 2005. As at 31 December 2005, the Group's cash and bank balances were approximately RMB140,220,000. (2004: RMB114,562,000). The Group continued to maintain a strong and healthy financial structure. Other than certain trust receipt loans grouped under trade and bill payables in the financial statements of the Year, the Group had no other short-term or long-term borrowings as at the end of year 2004 and 2005.

The Group's trade receivables turnover increased slightly from 32 days in 2004 to approximately 34 days in 2005. This was mainly due to the credit period granted to new energy materials and batteries customers were normally longer in accordance with the industry practice. Nevertheless, the Group have not experienced significant bad debt problems and continued to maintain a healthy record of trade receivables turnover.

With the inventory balance as at 31 December 2005 increased by approximately 1.1 times, the inventory turnover days increased from 36 days to 56 days.

Exposure to Foreign Exchange Risk

The Group is exposed to foreign currency risk primarily through currency exposures in sales and purchases that are denominated in United State Dollars ("USD") with respect of RMB which is the Group's functional currency. Foreign exchange risk arises from future commercial transactions and recognised assets and liabilities. 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 2005, the Group had no contingent liabilities.

Pledge of Assets

As at 31 December 2005, the Group did not pledge any assets (2004: Nil) as securities for the banking facilities granted by its bankers.

Human Resources

As at 31 December 2005, the Group had a total of approximately 680 employees (2004: 720 employees). Total staff costs (including directors' emoluments) for the Year was approximately RMB18,534,000 (2004: RMB17,124,000), representing 4% of the Group's turnover (2004: 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.