

## Management Report

### Dear shareholders,

Since the successful acquisition of the Fertilizer Group in July 2005, fertilizer business has become the principal business of the Group. With the trust and support of the Board of Directors, the new management team strictly observes their duty and keeps forging ahead in actively carrying out the strategy set by the Board – focusing on distribution and integrating production, supply and sales for synergic development – leading the Group to vigorously expand business operations and continuously improve the internal control system. As a result, the Group achieved remarkable performance, which further consolidated and enhanced the cutting edge of the Group in the China fertilizer market.

### I. Results Maintained Sustainable, Stable and Fast Growth in 2005

For the year ended 31 December 2005, the Group's fertilizer business achieved turnover of HK\$19,200 million, up 62.6% over the last year; and net profit reached HK\$779 million, up 52.6% over the last year. The fertilizer business realised annual turnover of HK\$7,300 million, HK\$9,800 million and HK\$11,800 million in 2002, 2003 and 2004 respectively, with an average annual growth rate of 27%. Net profits were HK\$226 million, HK\$391 million and HK\$511 million, respectively, with an average annual growth rate of 50%. Such stable and fast growth of the fertilizer business during these successive years was the result of the effective development strategy and the continuously improved management quality, as well as the efforts of all the employees.

Reviewing our profit structure, sourcing and distribution business contributed HK\$709 million to net profit after tax, which was an increase of 56.2% over the last year and accounted for 91% of the total net profit after tax of the Group. Production business contributed HK\$70 million to net profit after tax, an increase of 22.81% over the last year and accounted for 9% of the Group's total net profit after tax. The rapid growing profits from production and sourcing and distribution businesses reinforced the competitive advantages of the Group's integrated strategy of the synergic development of the upstream, midstream and downstream operations. As a result, the profit base of the Group was further consolidated.

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### II. Major Businesses Developed Rapidly and Internal Management Continuously Improved

The Group's strategy is predicated on the development of its domestic distribution network to increase its sales capabilities and market share, enhance the core competitiveness of the Group and production capacity and its bargaining power in procurement. In addition, the Group will fully capitalize on its advantages along the value chain from production to diversified procurement channels to achieve coordinated development of all upstream, midstream and downstream businesses.

#### (1) Distribution and Sales

The Group is the largest fertilizer distributor in China. For the year ended 31 December 2005, total sales volume reached 11.17 million tonnes, increased 34% over the last year and among which, sales volume of domestic fertilizers increased by 147% to 3.85 million tonnes, representing 34% of total sales, while that of imported fertilizers was 6.36 million tonnes, representing 57% of total sales and an increase of 7% over the last year. While maintaining a stable growth in imported fertilizer operations, the Group made great progress in enhancing the operating scale and capabilities of its domestic fertilizer business.

The Group has the most extensive fertilizer marketing and distribution network, which covers 20 major agriculture provinces in China, accounting for approximately 71% of the total arable land of the country. As at 31 December 2005, the Group had set up 14 branches and 1,063 sales outlets throughout the country. For the year ended 31 December 2005, products sold via the distribution network amounted to 7.28 million tonnes, accounting for 65% of total sales volume. The business model oriented on the grass-roots customers continued to make headways, scoring a 20% increase in customer base which includes mainly customers at the county and township levels. Such a unique distribution network acts as an "expressway" reaching the markets in China's vast rural areas.

Apart from its own distribution network, the Group also expanded sales through wholesale in regions not covered by the network, direct sales to compound fertilizers processing producers using nitrogen, phosphate and potash as raw materials, as well as export. Through a diversified marketing strategy with distribution playing a leading role, the marketing capabilities and market shares of the Group were improved, resulting in a broad and solid customer base.

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### (2) Production

The Group's investments focused on the fertilizer production projects which utilized non-renewable resources near the production base or were built close to the consumers. As at 31 December 2005, the Group had equity interest in seven fertilizer production companies with the aggregated fertilizer production capacity grew 17% to 2.73 million tonnes, in which 75% were phosphate fertilizers and 25% compound fertilizers produced from the non-renewable phosphoric rock. Sinochem Corporation, the ultimate holding company of the Company, has always extended its full support to the development of the Group, and granted the Group the options and preemptive right to purchase the three fertilizer production companies in which Sinochem Corporation has equity interest at fair market value and at appropriate time. The total production capacity of these three enterprises is 2.1 million tonnes, of which 1.5 million tonnes is potash fertilizer produced from the non-renewable potash. In addition, the Group has preference as to the sales of the products of these three enterprises, which has further enhanced the Group's position as a major fertilizer producer in China.

### (3) Sourcing

In addition to expanding supply channels from its own production sector, the Group also attached great importance to forming pluralized sourcing channels in the global marketplace for the stable supply of quality fertilizers. In 2005, the Group continued to solidify its strategic cooperation with major international fertilizer suppliers, and signed exclusive product distribution contracts with nine major international suppliers, maintaining market share of over 50% for both imported potash and compound fertilizers. In respect of sales, the Group is the largest distributor of imported fertilizers in China, and has successfully established a strong market position in terms of negotiation power, market share and brand awareness. On the other hand, the Group's purchase volume of domestic fertilizers rose along with its well established relationships with large-scale fertilizer producers in China. Domestic purchase volume in 2005 reached 4.31 million tonnes, increasing the percentage to total purchase volume from 23% of the previous year to 40%. Such diversified sourcing channels enabled the Group to offer an extensive range of product mix including nitrogen-based, phosphate-based, potash and compound fertilizers to cater to different customer needs in different regions.

### (4) Warehousing, Logistics and Agrichemical Services

In 2005, the Group continued to build a logistics operation system to complement its marketing and distribution strategy. Efforts were made to strengthen its cooperation with major destination ports of imported fertilizers such as Shanghai and Zhanjiang. Meanwhile the Group expanded its warehousing and distribution network in the inland fertilizer distribution centers and increased total warehousing capacity to 3 million tonnes.

Social responsibility and public image are always the prime concerns to the Group. In 2005, the Group persistently provided agrichemical services to farmers, including features at different media channels such as radio and newspapers, onsite exchanges with agrichemical experts and enquiry hotlines. These had enhanced farmers' knowledge of scientific fertilization and techniques, which in turn promoted the sales of the Group's products, and uplifted the brand image of "Sinochem Fertilizer" of the Group.

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### (5) Internal Control and Management

The management of the Group has always attached top priority to the protection of shareholders' asset value, and therefore taking the building of an advanced and standardized internal control and management system as the foundation for the Group's long-term, healthy development. Leveraging on the opportunity for initiating systematic innovations following the acquisition, the Group carried out a thorough review and revision of the various internal control policies and procedures with reference to international practices. Standardized transaction and contract approval procedures were set up for the principal operations of the Group, including upstream investment, product procurement and downstream distribution. The management information system comprising the SAP system and distribution management system (DMS) were implemented and expanded to cross-check and monitor logistics, cash flow and information flow. The Group carried out credit investigation and credit rating procedures on suppliers and customers, and optimised the inventory tracking and management system for product procurement and sales. Centralised and integrated capital management system for both overseas and domestic operations was adopted to consolidate the cash-oriented financial monitoring and approval of various transactions. In addition, the Group has optimised its internal control measures through continued reviews and identification of problems by a dynamic internal auditing mechanism. As a result, the Group has enhanced its risk management and operating efficiency, laying down a robust institutional basis for the long-term, healthy and rapid growth of the Group.

### (6) Human Resource Development

The Group places great importance on nurturing and developing human resources and source talents globally, providing competitive remuneration packages and a broad career platform. The remuneration policy of the Group has linked up the benefits of senior employees with corporate performance and shareholder value. The long-term and short-term benefits are combined under the Group's well established remuneration structure. This has resulted in the Group becoming a more attractive employer, able to retain and motivate various talents. In addition, the Company has adopted a share option scheme, linking the benefits of the management closely with the development of the Group, which is certainly conducive to promote the healthy and sustainable development of the Group.

## III. Outlook of 2006

Year 2006 is the first year of the eleventh Five-Year Plan period in China. In the great course of building "new socialist countryside", the government and various social forces have showed unprecedented enthusiasm in investing in the agricultural sector, the rural areas and the farmers. Meanwhile, the state will continue to encourage the development of the fertilizer industry in policy decision-making. All this has jointly created a favorable external environment for the future development of the Group. Under the guidance of the Board of Directors and in the spirit of diligence and professionalism, the management of the Group will lead its staff to utilise the combined advantages and synergic effects of the development model focusing on distribution and integrating production, supply and sales. The Group's advantageous sourcing channel and market position in imported fertilizers will be further strengthened; and huge efforts will be made to expand the three-in-one marketing service system which combines downstream product sales, warehousing and logistics and agrichemical services as a whole, as well as to boost the core competencies centering on distribution so as to completely attain various operating goals and development objectives set forth for 2006, and present the shareholders with higher returns.