CONTRIBUTION

Management's Discussion and Analysis

The Chinese government attaches enormous importance to the agricultural sector, and gives increasingly greater support to agricultural industry year from year. In the outline for the nation's "eleventh Five-Year Plan", it is put forward explicitly that more efforts should be made to build the "socialist new countryside", the industrial sector should repay the agricultural sector, and that the urban areas should help develop the rural areas. The central government further set down various favorable policies for the farmers, including the removal of agricultural tax nationwide; stabilizing, perfecting and strengthening the direct subsidy policies to agriculture and the farmers; resolutely implementing the most strict arable land protection system; as well as continuing and improving the floor price policy for key grain varieties. Central government budget expenditures for agriculture, rural areas and farmers have been on the increase, from RMB297.5 billion in 2005 to RMB339.7 billion in 2006. Through a series of "give-more-take-less" policies supporting the farmers, the central government hopes to further arouse the enthusiasm of grain producers and boost crop output so as to support the living of China's 1.3 billion population and guarantee the country's food security.

Chemical fertilizers play the utmost important role in increasing grain output. The Chinese population keeps rising, and yet the arable land per capita is decreasing, down from 1.59 mu in 2003 to 1.41 mu in 2004. Consequently, to increase grain production per unit of land by improving soil nutrients through fertilization is an important and effective strategy to ensure food supply of the country. According to statistical analysis, 40-50% of the increase in grain output depends on the increase in fertilizer application.

China is the largest fertilizer consumption country in the world with annual consumption in 2004 reaching 46.37 million tonnes (in nutrients), accounting for about one third of the world's total fertilizer consumption. The trend continued in 2005. The compound annual growth rate of China's fertilizer consumption was 3.4% between 1996 and 2004, above the world's average. Such a rapidly growing market has brought about vast prospects for the development of the Group.

As the largest integrated fertilizer company in China, the Group adheres to the strategy of "focusing on distribution and integrating production, supply and sales for synergic development." Priorities are given to vigorously expand the domestic distribution network so as to enhance sales abilities and market share, to build and consolidate the core competencies of the Group, and to optimize the capacity of production projects as well as to boost negotiating power in product sourcing. Meanwhile, the advantages of self-owned production enterprises and diversified sourcing channels have been brought into full play to provide the downstream distribution network with stable and sufficient supplies of fertilizer products. In addition, the integrated operations of production, supply and sales have been continuously strengthened to achieve the synergic development of the upstream and downstream businesses.

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For the year ended 31 December 2005, the Group achieved remarkable results through capitalising on the market opportunities and pushing forward the growth strategies:

- turnover for 2005 reached HK$19,249 million, increased 62.61% over 2004 (the average annual compound growth rate of the Group's turnover was 40.50% from 2003 to 2005); and

- net profit for 2005 was HK$779 million, increased 52.58% over 2004 (the average annual compound growth rate of the Group's net profit was 41.20% from 2003 to 2005).

I. Business Scale

(1) Sales volume

The Group's sales volume in 2005 was 11.17 million tonnes, an increase of 33.69% over 2004. The increase was mainly attributable to growth in domestic fertilizer sales and operation scale, while that of imported fertilizers remained stable. In 2005, the Group's sales volume of imported fertilizers slightly increased from 5.96 million tonnes in 2004 to 6.36 million tonnes. The sales volume of domestic fertilizers reached 3.85 million tonnes, a sharp increase of 146.79% as compared to 1.56 million tonnes of 2004. In addition, the sales of sulphur and other products also increased.

In terms of product structure, increase in the sales volume of potash fertilizers of 40.73% was mainly attributable to the improved sales of both imported and domestic potash products, sales volume of nitrogen-based and compound fertilizers increased by 91.78% and 58.46% respectively due to the significant growth in the domestic products. Sales volume of domestic phosphate-based fertilizers saw a moderate growth while that of the imported phosphate-based fertilizers declined substantially, which resulted in a decrease of 10.28% in the sales volume over the last year.

Management's Discussion and Analysis

(2) Turnover

Turnover of the Group for the year ended 31 December 2005 was HK$19,249 million, representing an increase of 62.61%, or HK$7,411 million over 2004, which was attributable to the 33.69% increase in sales volume and the 21.64% increase in the average selling price per tonne. The rising raw material prices, transportation cost and the change in the market demand and supply had pushed up the average selling price from HK$1,417 per tonne in 2004 to HK$1,723 per tonne in 2005.

	2005		2004	
	Turnover *HK$'000*	**As a percentage of turnover**	Turnover *HK$'000*	As a percentage of turnover
Potash fertilizers	**10,122,007**	**52.59%**	5,452,101	46.06%
Phosphate-based fertilizers	**2,641,101**	**13.72%**	3,092,695	26.13%
Nitrogen-based fertilizers	**3,010,152**	**15.64%**	1,318,981	11.14%
Compound fertilizers	**2,807,174**	**14.58%**	1,518,943	12.83%
Others	**668,231**	**3.47%**	454,465	3.84%
Total	**19,248,665**	**100.00%**	11,837,185	100.00%

II. Profit

(1) Gross profit margin

The gross profit margin of the Group in 2005 remained stable at 8.02%, decreased slightly from 8.66% in 2004 and within the range of 8%-9% for the last three years.

This slight change in gross profit margin was in line with the current business expansion of the Group. The Group has been making huge efforts to expand the distribution network and the domestic fertilizer business, incurring relatively large expenditures in setting up sales outlets, product and brand promotions, as well as logistics and warehousing, to some extent which affected the Group's overall gross profit margin. However, these expenditures will bring about benefits to the Group in the long term. The operating efficiency of the Group's distribution network will be enhanced, and domestic fertilizer operations will be strengthened, and the business scale of the Group will expand rapidly supported by a stable gross profit margin.

The Group's current profit model is to increase overall profit by continuously expanding the business scale while maintaining a basically stable profit margin.

In terms of the gross profit margin of various products, the gross profit margin of potash fertilizers increased steadily, which was mainly attributable to the expansion of the operation scale and the strengthening of market operating ability; the gross profit margin of compound fertilizers dropped as a result of the change of ratio in sales of imported products to domestic products; the gross profit margin of phosphate-based fertilizers and nitrogen-based fertilizers fell slightly due to increased sales volume of domestic products.

Management's Discussion and Analysis

(2) Share of results of jointly controlled entities

For the year ended 31 December 2005, the Group realised HK$50 million in share of results of five jointly controlled entities in which the Group had equity interests. This amount was 20.01% higher than the HK$42 million for 2004, which was mainly due to the sound performance and contributions from the jointly controlled entities of the Group in 2005.

(3) Net profit and net profit margin

For the year ended 31 December 2005, net profit of the Group reached HK$779 million, increased 52.58% over the 511 million of 2004. The increase was mainly attributable to the continuous implementation of the set development strategy in 2005, the effects of the integrated business model and a stable gross profit margin, as well as increased net profit along with the expansion of business scale. The stable improvement as such in the Group's financial performances during the last three years shows exactly the maturation and soundness of the Group's profit model.

Net profit margin of the Group in 2005 was 4.05%, decreased slightly from 4.32% for 2004. However, it was still within the range of 4%-4.5% as seen in the last three years. For the same reasons as the change in gross profit margin, the change in net profit margin was also in line with the Group's profit model and the current business expansion of the Group.

III. Expenditures

Selling and distribution expenses increased from HK$316 million in 2004 to HK$395 million in 2005, which was an increase of 24.92%, and mainly attributable to:

- sales volume increased by 33.69% over 2004, incurring proportionally higher transportation, loading and discharging expenses;
- additional logistics and storage expenses were incurred with the penetration of the sales model to end-users;

Administrative expenses increased from HK$119 million in 2004 to HK$223 million in 2005, which represented an increase of 87.88%, and mainly attributable to:

- further expansion of the sales network and substantial growth in the number of sales outlets and employees, which by the end of 2005 increased by 92.57% and 42.31%, respectively, over 2004;
- an inventory provision of HK$37 million was recorded for 2005;

Management's Discussion and Analysis

Finance costs increased from HK$47 million in 2004 to HK$112 million in 2005, which represented an increase of 138.51%, and mainly attributable to:

- increase in the utilization of fund resulted from increased sales activities;
- increase in finance cost because the basic lending rate of US dollar increased by 89% after eight consecutive increases in the interest rate for US dollar during 2005.

The Group's total expenditures increased from HK$482 million in 2004 to HK$730 million in 2005, increased 51.54%, yet the ratio of expenditures to turnover decreased from 4.07% in 2004 to 3.79% for 2005. The Group put great emphasis in cost control during the expansion of the operating scale and sales network, successfully keeping the increase rate of total expenditures lower than that of turnover.

IV. Cash Flow

Cash outflow of the Group in 2005 amounted to HK$151 million. Cash inflow from operating activities of HK$128 million was the funds arising from a faster turnover in trade receivables. Cash outflow from investing activities of HK$21 million was the collection of loans receivable of HK$205 million and the purchase of property, plant and equipment of HK$237 million. In addition, financing activities including the centralised capital operations and payment of bank loans incurred a cash outflow of HK$258 million.

V. Inventory Turnover

The inventory balance of the Group as at 31 December 2005 was HK$4,798 million, increased 22.95% over that of HK$3,903 million for 2004, which was mainly due to the increase of inventory cost per tonne (the average cost of goods sold increased by 22.50% over that of 2004). Inventories at 31 December 2005 were 3.354 million tonnes which was an increase of 5.7% over 2004, and in storage at the ports and inland warehouses.

The inventory turnover rate was increased with the distribution network expansion and the improvement of grass-roots level distribution abilities. The inventory turnover day decreased from 116 days in 2004 to 90 days in 2005, therefore improving the assets operating efficiency.

The Group retained a relatively high inventory level and the reasons were as follows:

- the characteristics of the fertilizer industry featuring balanced all-year-round production but seasonal selling, which requires certain amount of stock to prepare for the selling season in advance; and
- the Group's continuously expanding distribution network requires higher inventory level.

According to the inventory by products, potash fertilizers accounted for 52.37% of total balance as at 31 December 2005. Potash fertilizer, of which China lacks resources, is a core commodity of the Group, therefore the reserving of a relatively large potash inventory was of great significance to ensure domestic potash supply and the profitability of the Group.

Management's Discussion and Analysis

VI. Trade and Bills Receivables

The balance of the Group's trade and bills receivables was HK$847 million, an increase of 58.80% over the HK$533 million in 2004, but proportionate to the increase rate of 62.61% in the Group's turnover for year 2004. Trade and bills receivables of the Group also increased along with the expansion of business scale. The balance of trade and bills receivables accounted for only 4.40% of the total turnover; and there were strict policies in place to control the credit sales which was mainly given to the long-term business partners. In the past few years, there was no uncollectable overdue trade receivables.

Meanwhile, average debtors turnover day decreased from 14 days in 2004 to 13 days in 2005.

VII. Other Financial Indicators

Earnings per share (EPS) of the Group as at the end of 2005 was 14.49 HK cents, increased 43.18% as compared to 10.12 HK cents for 2005, which was mainly attributable to the significant increase in net profit in 2005.

Return on equity (ROE) of the Group was 22.43% in 2005, lower than that of last year. This was mainly because the new issued share capital for the acquisition and re-listing increased the equity by HK$768 million, which significantly increased the net assets. If the effect of this factor was subtracted, the ROE would have been 28.79%, slightly higher than that of 2004.

The current ratio of the Group increased from 1.27 in 2004 to 1.41 in 2005, indicating improved short-term solvency; and the Group's liabilities to equity ratio decreased from 86.06% in 2004 to 34.40% in 2005, falling by 51.66 percentage points, and indicating improved long-term solvency.

	2005	2004
Profitability		
Earnings per share (HK cents)	**14.49**	10.12
Return on equity *(Note 1)*	**22.43%**	26.87%
Return on equity *(Note 2)*	**28.79%**	26.87%
Solvency		
Current ratio *(Note 3)*	**1.41**	1.27
Debt to equity ratio *(Note 4)*	**34.40%**	86.06%

Note 1: Calculated based on profit attributable to Shareholders of the Company for the reporting periods divided by total equity attributable to Shareholders of the Company at the end of the reporting periods.

Note 2: Calculated based on profit attributable to Shareholders of the Company for the reporting periods divided by total equity attributable to Shareholders of the Company at the end of the reporting periods (excluding the effect of equity increase due to new share capital issued upon re-listing).

Note 3: Calculated based on the current assets divided by current liabilities at the end of the reporting periods.

Note 4: Calculated based on the total interest-bearing debt divided by total equity at the end of the reporting periods.

Management's Discussion and Analysis

VIII. Significant Items

(1) Liquidity and financial resources

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

As at 31 December 2005, cash and cash equivalents of the Group were HK$67 million, mainly denominated in Renminbi and US dollar.

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

	2005	2004
	HK$'000	*HK$'000*
Secured	**126,744**	180,502
Guaranteed	**13,044**	1,328,983
Unsecured	**1,119,352**	260,221
Total	**1,259,140**	1,769,706

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

As at 31 December 2005, the Group had banking facilities of HK$8,155 million, including US$385 million and RMB5,361 million, denominating in respective currencies. The amount of banking facilities already used was HK$3,488 million, and that of unused was HK$4,667 million.

(2) Financial risk management

The activities of the Group are challenged by various financial risks, including 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. The overall risk management program of the Group focuses on the difficult predictability of the financial market, and seeks to reduce to the greatest extent possible those potential factors that might negatively affect the Group's financial performance.

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(3) Contingent liabilities

As at 31 December 2005, the Group had no material contingent liabilities.

(4) Capital commitments

	2005	2004
	HK$'000	*HK$'000*
Assets under construction		
Contracted but not provided for	**71,922**	229,498
Authorized but not contracted for	**8,459**	17,358
Subtotal	**80,381**	246,856
Investment in a jointly controlled entity, Yunnan Three-Circles Sinochem Fertilizer Company Limited	**134,577**	131,616
Total	**214,958**	378,472

The amount of "contracted but not provided for" and "authorized but not contracted for" both referred to the assets under construction of Sinochem Fuling.

(5) Major investment

For the year ended 31 December 2005, the Group's major investment of HK$237 million represented the assets under construction of Sinochem Fuling.