Notes to Financial Statements

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1. GROUP REORGANISATION AND CORPORATE INFORMATION

The Company was incorporated in the People's Republic of China (the "PRC") on 1 September 2005 as a joint stock company with limited liability as a result of a group reorganisation (the "Reorganisation") of Hunan Nonferrous Metals Holdings Group Co., Ltd. ("HNG") in preparation for the listing of the Company's shares on The Stock Exchange of Hong Kong Limited. HNG is a state-owned enterprise established in August 2004 in the PRC, and is under the control of the People's Government of Hunan Province.

Pursuant to the Reorganisation, HNG effected the transfer of the following to the Company upon its incorporation:

(i) the nonferrous metal mining business of Hunan Huangshaping Lead and Zinc Mine, a wholly-owned subsidiary of HNG, together with related assets and liabilities;

(ii) the shareholding interests in certain subsidiaries and associates which principally carry on the business of mining and smelting of nonferrous metals and engage in the manufacture of cemented carbides, and tungsten, molybdenum, tantalum, niobium and their compounds, after carving out (i) the assets, liabilities and interests in relation to non-core businesses which are unrelated to the aforesaid businesses transferred to the Group; and (ii) certain assets and liabilities including staff quarters, buildings, bank balances, investments in securities and creditors to companies controlled by HNG; and

(iii) a 4.68% shareholding interest in Hunan Zhuye Torch Metals Co., Ltd. ("Zhuye Torch").

In addition, as part of the Reorganisation, Zhuzhou Smelter Group Co., Ltd. ("Zhuye"), a subsidiary of the Company, entered into various agreements with China Orient Asset Management Corporation ("COAMC"). Pursuant to these agreements, COAMC agreed to give up its 48.35% equity interest in Hunan Zhuye Nonferrous Metals Co., Ltd. ("Zhuye Nonferrous"), a company owned as to 51.65% by Zhuye and 48.35% by COAMC, in exchange for an equity interest of 36.686% in Zhuye. Thereafter, Zhuye Nonferrous' entire assets and liabilities as at 31 December 2004 were transferred to Zhuye, and Zhuye Nonferrous was dissolved. The Company's interest in Zhuye was reduced from 100% to 63.314% upon the completion of the Reorganisation.

The above assets and liabilities and the shareholding interests in certain subsidiaries and associates transferred to the Company are collectively known as the "Relevant Businesses". The effective date of the Reorganisation was 31 December 2004.

HNG and its subsidiaries (the "HNG Group") retains (i) the ownership of certain assets and liabilities including staff quarters, certain office buildings, bank balances, investments in securities and borrowings; and (ii) the non-core businesses together with relevant assets and liabilities.

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1. GROUP REORGANISATION AND CORPORATE INFORMATION *(continued)*

The consolidated financial statements for the year ended 31 December 2004 includes the Relevant Businesses together with the non-core businesses and certain assets and liabilities historically owned by the Relevant Businesses and carved out to the HNG Group pursuant to the Reorganisation at the effective date of 31 December 2004, whereas the consolidated financial statements for the year ended 31 December 2005 included the Relevant Businesses only. The results of the Relevant Businesses are dealt with in the Group's consolidated income statement as the results of continuing operations. During the year ended 31 December 2004, the Group's continuing operations granted social function subsidies of RMB58,869,000 to the discontinued non-core businesses and such subsidies are recorded as administrative expenses under continuing operations in the consolidated income statement.

The non-core businesses were transferred to the HNG Group as of 31 December 2004 on which the Reorganisation took effect. The Group's continuing operations ceased to bear such social function subsidy expenses starting from 1 January 2005.

The Company issued 2,091,260,000 ordinary shares of RMB1.00 each to HNG, credited as fully paid, as consideration for HNG transferring the Relevant Businesses to the Company. Shenzhen City Bangxin Investment Development Co., Ltd. ("Shenzhen Bangxin"), Zijin Mining Group Co., Ltd., Hunan Valin Steel ("Hunan Valin") and Iron Group Co., Ltd. and Powerise Information Technology Co., Ltd. (collectively the "Other Promoters") injected cash into the Company in an aggregate amount of RMB92,500,000 as consideration for the Company's paid-up capital of an aggregate of 92,500,000 shares of RMB1.00 each. As a result, 95.76% and 4.24% of the share capital of the Company were owned by HNG and the Other Promoters, respectively.

In March 2006, the Company issued 1,075,582,000 new H shares to the public at a price of HK$1.65 per share (equivalent to approximately RMB1.70 per share) and such H shares were listed on the Main Board of The Stock Exchange of Hong Kong Limited. In addition, 107,558,000 H shares converted from certain domestic shares held by HNG, Shenzhen Bangxin and Hunan Valin were transferred to the National Council for the Social Security Fund.

In April 2006, as a result of the over-allotment option as detailed in the Company's prospectus dated 21 March 2006, the Company issued 161,336,000 new H shares to the public at a price of HK$1.65 per share (equivalent to approximately RMB1.70 per share) and such H shares were listed on the Main Board of The Stock Exchange of Hong Kong Limited. In addition, 16,134,000 H shares converted from certain domestic shares held by HNG, Shenzhen Bangxin and Hunan Valin were transferred to the National Council for the Social Security Fund.

The registered office of the Company is located at 11th Floor, Block A, Youse Building, No. 342 Laodongxi Road, Changsha City, Hunan, PRC.

1. GROUP REORGANISATION AND CORPORATE INFORMATION *(continued)*

The Company and its subsidiaries are principally engaged in the mining and smelting of nonferrous metals and the manufacturing of cemented carbides, and tungsten, molybdenum, tantalum, niobium and their compounds.

In the opinion of the directors, the parent and ultimate holding company of the Group is HNG, which is incorporated in the PRC.

2.1 BASIS OF PREPARATION

These financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRSs"), which comprise standards and interpretations approved by the International Accounting Standards Board, and International Accounting Standards and Standing Interpretations Committee interpretations approved by the International Accounting Standards Committee that remain in effect, and the disclosure requirements of the Hong Kong Companies Ordinance (the "Companies Ordinance"). They have been prepared under the historical cost convention, except for the measurement at fair value of available-for-sale financial assets and other financial assets.

As the People's Government of Hunan Province ultimately controlled the Relevant Businesses before the Reorganisation and continues to have ultimate control over the Group after the Reorganisation, the Reorganisation has been accounted for as a reorganisation of entities under common control in a manner similar to pooling of interests. As a result, these financial statements have been prepared on the basis as if the Relevant Businesses had been transferred to the Group at the beginning of the year ended 31 December 2004. Accordingly, the assets and liabilities transferred to the Company have been stated at historical amounts.

These financial statements are prepared on the going concern basis although the Group's current liabilities exceeded its current assets as at 31 December 2005. This is because the directors are of the opinion that the Group has obtained sufficient funding subsequent to its issue of new shares to the public and listing on the Main Board of The Stock Exchange of Hong Kong Limited on 31 March 2006 such that the Group will have adequate funds to meet its liabilities when they fall due.

The consolidated financial statements are presented in Renminbi ("RMB") and all values are rounded to the nearest thousand except when otherwise indicated.

Basis of consolidation

The consolidated financial statements include the financial statements of the Company and its subsidiaries after elimination of intercompany transactions.

Subsidiaries are consolidated from the date on which control is transferred to the Group and cease to be consolidated from the date on which control is transferred out of the Group. Where there is a loss of control of a subsidiary, the consolidated financial statements include the results for the part of the reporting year during which the Group has control.

Notes to Financial Statements

31 December 2005

2.1 BASIS OF PREPARATION *(continued)*

Basis of consolidation *(continued)*

Minority interests represent the interests of outside shareholders in the results and net assets of the Company's subsidiaries.

The acquisition of subsidiaries by the Group has been accounted for using the purchase method of accounting. The purchase method of accounting involves allocating the cost of a business combination to the fair value of the assets acquired and liabilities and contingent liabilities assumed at the date of acquisition.

2.2 IMPACT OF ISSUED BUT NOT YET EFFECTIVE INTERNATIONAL FINANCIAL REPORTING STANDARDS

The Group has not applied the following IFRSs and International Financial Reporting Interpretations ("IFRICs") that have been issued but are not yet effective. Unless otherwise stated, these IFRSs and IFRICs are effective for annual periods beginning on or after 1 January 2006:

IAS 1 (Amendment)	Capital Disclosures
IAS 19 (Amendment)	Actuarial Gains and Losses, Group Plans and Disclosures
IAS 21 (Amendment)	Net Investment in a Foreign Operation
IAS 39 (Amendment)	Cash Flow Hedge Accounting of Forecast Intragroup Transactions
IAS 39 (Amendment)	The Fair Value Option
IAS 39 & IFRS 4 (Amendments)	Financial Guarantee Contracts
IFRSs 1 & 6 (Amendment)	First-time Adoption of International Financial Reporting Standards and Exploration for and Evaluation of Mineral Resources
IFRS 6	Exploration for and Evaluation of Mineral Resources
IFRS 7	Financial Instruments: Disclosures
IFRIC – Int 4	Determining whether an Arrangement contains a Lease
IFRIC – Int 5	Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds
IFRIC – Int 6	Liabilities arising from Participating in a Specific Market – Waste Electrical and Electronic Equipment
IFRIC – Int 7	Applying the Restatement Approach under IAS 29 *Financial Reporting in Hyperinflationary Economies*
IFRIC – Int 8	Scope of IFRS 2

The Group has commenced its assessment of the impact of these standards and interpretations but it is not yet in a position to state whether these standards and interpretations would have a material impact on its results of operations and financial position.

2.3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Subsidiaries

A subsidiary is an entity whose financial and operating policies the Company controls, directly or indirectly, so as to obtain benefits from its activities.

The results of subsidiaries are included in the Company's income statement to the extent of dividends received and receivable. The Company's investments in subsidiaries are stated in the Company's balance sheet at cost less any impairment losses.

Associates

The Group's interests in associates are accounted for under the equity method of accounting. Associates are entities in which the Group has significant influence and which are neither subsidiaries nor jointly-controlled entities.

The interests in associates are carried in the consolidated balance sheet at cost plus post-acquisition changes in the Group's share of net assets of the associates, less any impairment in value. The consolidated income statement reflects the Group's share of the results of operation of the associates.

Goodwill

Goodwill acquired in a business combination is initially measured at cost, being the excess of the cost of the business combination over the Group's interests in the net fair value of the identifiable assets, liabilities and contingent liabilities. Following initial recognition, goodwill is measured at cost less any accumulated impairment losses. Goodwill is reviewed for impairment, annually or more frequently, if events or changes in circumstances indicate that the carrying value may be impaired.

Any excess of the Group's interests in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities over the cost of the acquisition of subsidiaries, after reassessment, is recognised immediately in the consolidated income statement.

Notes to Financial Statements

31 December 2005

2.3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Foreign currencies

These financial statements are presented in Renminbi, which is the Company's functional and presentation currency. Each entity in the Group determines its own functional currency and items included in the financial statements of each entity are measured using that functional currency. Foreign currency transactions are initially recorded using the functional currency rates ruling at the date of the transactions. Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency rates of exchange ruling at the balance sheet date. All differences are taken to the consolidated income statement. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates at the dates of the initial transactions. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined.

On consolidation, the financial statements of overseas subsidiaries are translated into Renminbi. As at the balance sheet date, the assets and liabilities of these entities are translated into the presentation currency of the Company at the exchange rates ruling at the balance sheet date and, their income statements are translated into Renminbi at the weighted average exchange rates for the year. The resulting exchange differences are included in the exchange fluctuation reserve. On disposal of a foreign entity, the deferred cumulative amount recognised in equity relating to that particular foreign operation is recognised in the consolidated income statement.

For the purpose of the consolidated cash flow statement, the cash flows of overseas subsidiaries are translated into Renminbi at the exchange rates ruling at the dates of the cash flows. Frequently recurring cash flows of overseas subsidiaries which arise throughout the year are translated into Renminbi at the weighted average exchange rates for the year.

Property, plant and equipment and depreciation

Property, plant and equipment, which consist of buildings and mining structures, plant, machinery and equipment and construction in progress, are stated at cost less accumulated depreciation and any impairment losses. The cost of an item of property, plant and equipment comprises its purchase price and any directly attributable costs of bringing the asset to its working condition and location for its intended use. Expenditure incurred after property, plant and equipment have been put into operation, such as repairs and maintenance, is normally charged to the consolidated income statement in the period in which it is incurred. In situations where it can be clearly demonstrated that the expenditure has resulted in an increase in the future economic benefits expected to be obtained from the use of an item of property, plant and equipment, and where the cost of the item can be measured reliably, the expenditure is capitalized as an additional cost of that asset.

2.3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Property, plant and equipment and depreciation *(continued)*

Depreciation is calculated on the straight-line basis to write off the cost of each asset over its estimated useful life, after taking into account their estimated residual value. The estimated useful lives of property, plant and equipment are as follows:

	Estimated useful life
Buildings and mining structures	20 to 40 years
Plant, machinery and equipment	5 to 15 years

The gain or loss on disposal or retirement of a property, plant and equipment recognised in the consolidated income statement is the difference between the net sales proceeds and the carrying amount of the relevant asset at the time of disposal.

Construction in progress

Construction in progress represents buildings, plant, machinery and equipment under construction and pending installation, which is stated at cost less any impairment losses, and is not depreciated. Cost comprises direct costs of construction and interest charges on related borrowed funds during the period of construction, installation and testing. Construction in progress is reclassified to the appropriate category of property, plant and equipment when completed and ready for use.

Lease prepayments

Lease prepayments represent the cost of land use rights paid to the PRC government authorities. Land use rights are stated at cost less accumulated amortisation and any impairment losses. The land use rights are amortised on the straight-line basis over the terms of the rights of 50 years.

Intangible assets

The useful lives of intangible assets are assessed to be either finite or indefinite. Intangible assets with finite lives are amortised over the useful economic life and assessed for impairment whenever there is an indication that the intangible asset may be impaired. The amortisation period and the amortisation method for an intangible asset are reviewed at least at each balance sheet date.

Mining rights

Mining rights are stated at cost less accumulated amortisation and any impairment losses. The mining rights are amortised on the straight-line basis over the shorter of the periods of the rights and the estimated useful lives of the mines in accordance with the production plans of the entities concerned and the proven and probable reserves of the mines on the units of production method.

Notes to Financial Statements 31 December 2005

2.3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Intangible assets *(continued)*

Technical know-how

Technical know-how is stated at cost less accumulated amortisation and any impairment losses. The technical know-how is amortised over a period of 10 to 20 years.

Research and development costs

Research costs are expensed as incurred. Development expenditure incurred on an individual project is carried forward when its future recoverability can reasonably be regarded as assured. Following the initial recognition of the development expenditure, the cost model is applied requiring the asset to be carried at cost less any accumulated amortisation and accumulated impairment losses. Any expenditure capitalised is amortised over the period of expected future sales from the related project.

The carrying value of development costs is reviewed for impairment annually when the asset is not yet in use, or otherwise when events or changes in circumstances indicate that the carrying value may not be recoverable.

Impairment of assets

The Group assesses at each reporting date whether there is an indication that an asset may be impaired. If any such indication exists, or when annual impairment testing for an asset is required, the Group makes an estimate of the asset's recoverable amount. An asset's recoverable amount is the higher of an asset's or cash-generating unit's fair value less costs to sell and its value in use and is determined for an individual asset, unless the asset does not generate cash inflows that are largely independent of those from other assets or groups of assets. Where the carrying amount of an asset exceeds its recoverable amount, the asset is considered impaired and is written down to its recoverable amount. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. Impairment losses of continuing operations are recognised in the consolidated income statement in those expense categories consistent with the function of the impaired asset.

2.3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Impairment of assets *(continued)*

An assessment is made at each reporting date as to whether there is any indication that previously recognised impairment losses may no longer exist or may have decreased. If such indication exists, the recoverable amount is estimated. A previously recognised impairment loss is reversed only if there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognised. If that is the case the carrying amount of the asset is increased to its recoverable amount, that increased amount cannot exceed the carrying amount that would have been determined, net of depreciation, had no impairment loss been recognised for the asset in prior years. Such reversal is recognised in the consolidated income statement unless the asset is carried at revalued amount, in which case the reversal is treated as a revaluation increase. After such a reversal, the depreciation charge is adjusted in future periods to allocate the asset's revised carrying amount, less any residual value, on a systematic basis over its remaining useful life.

Investments and other financial assets

Financial assets in the scope of IAS39 are classified as financial assets at fair value through profit or loss, loans and receivables, held-to-maturity investments and available-for-sale financial assets, as appropriate. When financial assets are recognised initially, they are measured at fair value, plus, in the case of investments not at fair value through profit or loss, directly attributable transaction costs. The Group determines the classification of its financial assets after initial recognition and, where allowed and appropriate, re-evaluates this designation at the balance sheet date.

All regular way purchases and sales of financial assets are recognised on the trade date, i.e., the date that the Group commits to purchase the asset. Regular way purchases or sales are purchases or sales of financial assets that require delivery of assets within the period generally established by regulation or convention in the marketplace.

Financial assets at fair value through profit or loss

Financial assets classified as held for trading are included in the category "financial assets at fair value through profit or loss". Financial assets are classified as held for trading if they are acquired for the purpose of sale in the near term. Derivatives are also classified as held for trading unless they are designated as effective hedging instruments. Gains or losses on investments held for trading are recognised in the consolidated income statement.

Notes to Financial Statements

31 December 2005

2.3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Investments and other financial assets *(continued)*

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Such assets are carried at amortised cost using the effective interest method. Gains and losses are recognised in the consolidated income statement when the loans and receivables are derecognised or impaired, as well as through the amortisation process.

Held-to-maturity investments

Non-derivative financial assets with fixed or determinable payments and fixed maturity are classified as held-to-maturity when the Group has the positive intention and ability to hold to maturity. Investments intended to be held for an undefined period are not included in this classification. Other long term investments that are intended to be held to maturity, such as bonds, are subsequently measured at amortised cost. Amortised cost is computed as the amount initially recognised minus principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between the initially recognised amount and the maturity amount. This calculation includes all fees and points paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums and discounts. For investments carried at amortised cost, gains and losses are recognised in the consolidated income statement when the investments are derecognised or impaired, as well as through the amortisation process.

Available-for-sale financial assets

Available-for-sale financial assets are non-derivative financial assets in listed and unlisted equity securities that are designated as available for sale or are not classified in any of the other three categories. After initial recognition, available-for-sale financial assets are measured at fair value, with gains or losses recognised as a separate component of equity until the investment is derecognised or until the investment is determined to be impaired, at which time the cumulative gain or loss previously reported in equity is included in the consolidated income statement.

When the fair value of unlisted equity securities cannot be reliably measured because (a) the variability in the range of reasonable fair value estimates is significant for that investment or (b) the probabilities of the various estimates within the range cannot be reasonably assessed and used in estimating fair value, such securities are stated at cost less any impairment losses.

2.3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Investments and other financial assets *(continued)*

Fair value

The fair value of investments that are actively traded in organised financial markets is determined by reference to quoted market bid prices at the close of business at the balance sheet date. For investments where there is no active market, fair value is determined using valuation techniques. Such techniques include using recent arm's length market transactions; reference to the current market value of another instrument which is substantially the same; a discounted cash flow analysis; and option pricing models.

Inventories

Inventories are stated at the lower of cost and net realisable value. Cost is determined on the weighted average basis and, in the case of work in progress and finished goods, comprises direct materials, direct labour and an appropriate proportion of manufacturing overheads.

The by-products produced during the course of production are stated at the lower of the processing costs of the by-products subsequent to the split-off and net realizable value.

Net realisable value is based on estimated selling prices less any estimated costs to be incurred to completion and disposal.

Trade and other receivables

Trade and other receivables are recognised and carried at original invoice amounts less allowances for any uncollectible amounts. An estimate for doubtful debts is made when collection of the full amount is no longer probable. Bad debts are written off as incurred.

Cash and cash equivalents

For the purpose of the consolidated cash flow statement, cash and cash equivalents comprise cash on hand and demand deposits, and short term highly liquid investments which are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value, and have a short maturity of generally within three months when acquired, less bank overdrafts which are repayable on demand and form an integral part of the Group's cash management.

For the purpose of the balance sheet, cash and cash equivalents comprise cash on hand and at banks, including term deposits, which are not restricted as to use.

Notes to Financial Statements

31 December 2005

2.3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Provisions

A provision is recognised when a present obligation (legal or constructive) has arisen as a result of a past event and it is probable that a future outflow of resources will be required to settle the obligation, provided that a reliable estimate can be made of the amount of the obligation.

When the effect of discounting is material, the amount recognised for a provision is the present value at the balance sheet date of the future expenditures expected to be required to settle the obligation. The increase in the discounted present value amount arising from the passage of time is included in finance costs in the income statement.

Interest-bearing loans and borrowings

All loans and borrowings are initially recognised at the fair value of the consideration received less directly attributable transaction costs.

After initial recognition, interest-bearing loans and borrowings are subsequently measured at amortised cost using the effective interest method.

Gains and losses are recognised in net profit or loss when the liabilities are derecognised as well as through the amortisation process.

Derecognition of financial assets and liabilities

Financial assets

A financial asset (or, where applicable, a part of a financial asset or part of a group of similar financial assets) is derecognised where:

- the rights to receive cash flows from the asset have expired;
- the Group retains the rights to receive cash flows from the asset, but has assumed an obligation to pay in full without material delay to a third party under a "pass-through" arrangement; or
- the Group has transferred its rights to receive cash flows from the asset and either (a) has transferred substantially all the risks and rewards of the asset, or (b) has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

2.3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Derecognition of financial assets and liabilities *(continued)*

Financial assets (continued)

Where the Group has transferred its rights to receive cash flows from an asset and has neither transferred nor retained substantially all the risks and rewards of the asset nor transferred control of the asset, the asset is recognised to the extent of the Group's continuing involvement in the asset. Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration that the Group could be required to repay.

Where continuing involvement takes the form of a written and/or purchased option (including a cash-settled option or similar provision) on the transferred asset, the extent of the Group's continuing involvement is the amount of the transferred asset that the Group may repurchase, except in the case of a written put option (including a cash-settled option or similar provision) on an asset measured at fair value, where the extent of the Group's continuing involvement is limited to the lower of the fair value of the transferred asset and the option exercise price.

Financial liabilities

A financial liability is derecognised when the obligation under the liability is discharged or cancelled or expires.

When an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and a recognition of a new liability, and the difference between the respective carrying amounts is recognised in profit or loss.

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31 December 2005

2.3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Impairment of financial assets

The Group assesses at each balance sheet date whether there is any objective evidence that a financial asset or a group of financial assets is impaired.

Assets carried at amortised cost

If there is objective evidence that an impairment loss on loans and receivables carried at amortised cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate (i.e., the effective interest rate computed at initial recognition). The carrying amount of the asset is reduced either directly or through the use of an allowance account. The amount of the impairment loss is recognised in profit or loss.

The Group first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant. If it is determined that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, the asset is included in a group of financial assets with similar credit risk characteristics and that group is collectively assessed for impairment. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed. Any subsequent reversal of an impairment loss is recognised in the income statement, to the extent that the carrying value of the asset does not exceed its amortised cost at the reversal date.

Assets carried at cost

If there is objective evidence that an impairment loss on an unquoted equity instrument that is not carried at fair value because its fair value cannot be reliably measured has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the current market rate of return for a similar financial asset. Impairment losses on these assets are not reversed.

Available-for-sale financial assets

If an available-for-sale asset is impaired, an amount comprising the difference between its cost (net of any principal payment and amortisation) and its current fair value, less any impairment loss previously recognised in profit or loss, is transferred from equity to the consolidated income statement. Impairment losses on equity instruments classified as available for sale are not reversed through profit or loss.

2.3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Borrowing costs

Borrowing costs directly attributable to the acquisition, construction or production of qualifying assets, i.e., assets that necessarily take a substantial period of time to get ready for their intended use or sale, are capitalised as part of the cost of those assets. The capitalisation of such borrowing costs ceases when the assets are substantially ready for their intended use or sale.

All other borrowing costs are recognised as expenses in the consolidated income statement in the period in which they are incurred.

Operating leases

Leases where substantially all the rewards and risks of ownership of assets remain with the lessor are accounted for as operating leases. Where the Group is the lessor, assets leased by the Group under operating leases are included in non-current assets, and rentals receivable under the operating leases are credited to the consolidated income statement on the straight-line basis over the lease terms. Where the Group is the lessee, rentals payable under the operating leases are charged to the consolidated income statement on the straight-line basis over the lease terms.

Income tax

Income tax comprises current and deferred tax. Income tax is recognised in the consolidated income statement, or in equity if it relates to items that are recognised in the same or a different period directly in equity.

PRC corporate income tax is provided at rates applicable to enterprises in the PRC on the Company and its subsidiaries' income for financial reporting purposes, as adjusted for income and expense items which are not assessable or deductible for income tax purposes.

Current tax assets and liabilities for the current and prior periods are measured at the amount expected to be recovered from or paid to the taxation authorities.

Deferred tax is provided, using the liability method, on all temporary differences at the balance sheet date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes.

Deferred tax liabilities are recognised for all taxable temporary differences, except:

- where the deferred tax liability arises from goodwill or the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and

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2.3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Income tax *(continued)*

- in respect of taxable temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, where the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future.

Deferred tax assets are recognised for all deductible temporary differences, carryforward of unused tax credits and unused tax losses, to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, and the carryforward of unused tax credits and unused tax losses can be utilised except:

- where the deferred tax asset relating to the deductible temporary differences arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and

- in respect of deductible temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, deferred tax assets are only recognised to the extent that it is probable that the temporary differences will reverse in the foreseeable future and taxable profit will be available against which the temporary differences can be utilised.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilised. Conversely, previously unrecognised deferred tax assets are reassessed at each balance sheet date and are recognised to the extent that it is probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilised.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted at the balance sheet date.

Deferred tax assets and deferred tax liabilities are offset, if a legally enforceable right exists to set off current tax assets against current tax liabilities and the deferred taxes relate to the same taxable entity and the same taxation authority.

2.3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Government grants

Government grants are recognised at their fair value where there is reasonable assurance that the grant will be received and all attaching conditions will be complied with. When the grant relates to an expense item, it is recognised as income over the periods necessary to match the grant on a systematic basis to the costs that it is intended to compensate. Where the grant relates to an asset, the fair value is credited to a deferred income account and is released to the consolidated income statement over the expected useful life of the relevant asset by equal annual instalments.

Revenue recognition

Revenue is recognised when it is probable that the economic benefits will flow to the Group and when the revenue can be measured reliably, on the following bases:

(a) from the sale of goods, when the significant risks and rewards of ownership have been transferred to the buyer, provided that the Group maintains neither managerial involvement to the degree usually associated with ownership, nor effective control over the goods sold;

(b) rental income, on a time proportion basis over the lease terms;

(c) interest income, on an accrual basis using the effective interest method by applying the rate that discounts the estimated future cash receipts through the expected life of the financial instrument to the net carrying amount of the financial asset; and

(d) dividend income, when the shareholders' right to receive payment has been established.

Employee benefits

(i) Pension obligations

The Company and its subsidiaries which were established in the Mainland China are required to participate in a central pension scheme operated by relevant municipal and provincial governments in the PRC. The Group contributes on a monthly basis to various defined contribution retirement benefit plans. The municipal and provincial governments undertake to assume the retirement benefit obligations payable to all existing and future retired employees under these plans and the Group has no further obligation for post-retirement benefits beyond the contributions made. The contributions are charged to the consolidated income statement as they become payable in accordance with the rules of the central pension scheme.

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2.3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Employee benefits *(continued)*

(i) Pension obligations (continued)

In addition, the Group also paid supplementary pension subsidies to retired employees. As detailed in notes 6(d) and (e) below, such supplementary pension payables as of 31 December 2004 were assessed using the projected unit credit method; the cost of providing such subsidies is charged to the consolidated income statement so as to spread the service cost over the average service lives of such former employees, in accordance with the actuarial reports which contained full valuations of plans. The Group terminated the supplementary pension subsidies attributed to employee services rendered on 1 January 2005 and thereafter.

These supplementary pension obligations are measured at the present value of the estimated future cash outflows using interest rates of government securities which have terms to maturity approximating the terms of the related liability. Actuarial gains and losses are recognised in the period in which they were incurred.

(ii) Early retirement benefits

Termination benefits are payable whenever an employee's employment is terminated involuntarily before the normal retirement date or whenever an employee accepts voluntary redundancy in exchange for the benefits. The Group recognizes termination benefits when it is demonstrably committed to terminating the employment of current employees according to a detailed formal plan without possibility of withdrawal or to providing termination benefits as a result of an offer made to encourage voluntary redundancy.

Related parties

A party is considered to be related to the Group if:

(a) the party, directly or indirectly through one or more intermediaries, (i) controls, is controlled by, or is under common control with, the Group; (ii) has an interest in the Group that gives it significant influence over the Group; or (iii) has joint control over the Group;

(b) the party is an associate;

(c) the party is a jointly-controlled entity;

(d) the party is a member of the key management personnel of the Group or its parent;

2.3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Related parties *(continued)*

(e) the party is a close member of the family of any individual referred to in (a) or (d); or

(f) the party is an entity that is controlled, jointly controlled or significantly influenced by or for which significant voting power in such entity resides with, directly or indirectly, any individual referred to in (d) or (e).

3. SIGNIFICANT ACCOUNTING JUDGEMENTS AND ESTIMATES

Estimation uncertainty

The key assumptions concerning the future and other key sources of estimation uncertainty at the balance sheet date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year, are discussed below.

Provision for obsolete inventories

Management reviews the condition of inventories of the Group at each balance sheet date and makes provision for obsolete and slow-moving inventory items identified that are no longer suitable for sale. Management estimates the net realisable value for such inventories based primarily on the latest invoice prices and current market conditions. Management reassesses the estimation at each balance sheet date.

Mine reserves

Engineering estimates of the Group's mine reserves are inherently imprecise and represent only approximate amounts because of the subjective judgements involved in developing such information. There are authoritative guidelines regarding the engineering criteria that have to be met before estimated mine reserves can be designated as "proved" and "probable". Proved and probable mine reserve estimates are updated on a regular basis and have taken into account recent production and technical information about each mine. In addition, as prices and cost levels change from year to year, the estimate of proved and probable mine reserves also changes. This change is considered a change in estimate for accounting purposes and is reflected on a prospective basis in related amortisation rates of mining rights.

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3. SIGNIFICANT ACCOUNTING JUDGEMENTS AND ESTIMATES *(continued)*

Estimation uncertainty *(continued)*

Mine reserves (continued)

Despite the inherent imprecision in these engineering estimates, these estimates are used in determining amortisation expenses and impairment losses of mining rights. Amortisation rates are determined based on estimated proved and probable mine reserve quantity and capitalised costs of mining rights. The capitalised cost of mining rights are amortised over the shorter of the periods of the rights on the straight-line basis or the estimated useful lives of the mines in accordance with the production plans of the entities concerned and the proven and probable reserves of the mines using the units of production method.

Income tax

The Group is subject to income taxes in various regions within the PRC. Since certain matters relating to the income taxes have not been confirmed by the local tax bureau, objective estimates and judgements based on currently enacted tax laws, regulations and other related policies are required in determining the provision of income taxes to be made. Where the final tax outcome of these matters are different from the amounts originally recorded, the differences will impact the income tax and tax provisions in the period in which the differences realise.

4. SEGMENT INFORMATION

The Group's operating businesses are structured and managed separately according to the nature of their operations and the products and services they provide. Each of the Group's business segment represents a strategic business unit that offers products and services which are subject to risks and returns that are different from those of the other business segments. Summary details of the business segments are as follows:

(a) Nonferrous metal mine site segment: mining and trading of nonferrous metals;

(b) Nonferrous metal smelting segment: smelting and trading of nonferrous metals;

(c) Cemented carbides, and tungsten, molybdenum, tantalum, niobium and their compounds segment: manufacture and trading of hard alloys and refractory metal compounds such as cemented carbides, and tungsten, molybdenum, tantalum, niobium and their compounds.

In determining the Group's geographical segments, revenues are attributed to the segments based on the location of the customers, and assets are attributed to the segments based on the location of the assets.

4. SEGMENT INFORMATION *(continued)*

(a) Business segments

The following tables present revenue, profit and certain asset, liability and expenditure information for the Group's business segments for the years ended 31 December 2005 and 2004.

Year ended 31 December 2005	Nonferrous metal mine site RMB'000	Nonferrous metal smelting RMB'000	Cemented carbides, and tungsten, molybdenum, tantalum, niobium and their compounds RMB'000	Corporate and others RMB'000	Eliminations RMB'000	Consolidated RMB'000
Continuing operations:						
Segment revenue:						
Sales to external customers	1,621,850	5,343,581	2,369,533	–	–	9,334,964
Intersegment sales	261,198	132	–	–	(261,330)	–
Less: Sales tax and surcharge	(14,300)	(17,344)	(12,088)	–	–	(43,732)
Total	1,868,748	5,326,369	2,357,445	–	(261,330)	9,291,232
Segment results	314,120	211,811	265,771	(6,027)	–	785,675
Interest and dividend income						12,387
Finance costs						(174,489)
Share of profits of associates	–	24,203	23,457	–	–	47,660
Profit before tax from continuing operations						671,233
Income tax expense						(133,978)
Net profit for the year from continuing operations						537,255
Discontinued operations:						
Profit for the year from discontinued operations						–
Net profit for the year						537,255
Assets and liabilities						
Segment assets	2,281,240	4,524,661	3,007,067	74,472	–	9,887,440
Interests in associates	–	11,695	28,198	–	–	39,893
Unallocated assets						105,079
Total assets						10,032,412
Segment liabilities	1,115,756	956,623	575,239	609	–	2,648,227
Unallocated liabilities						4,178,311
Total liabilities						6,826,538
Other segment information:						
Depreciation and amortisation	55,403	129,881	147,059	171	–	332,514
Capital expenditure	753,301	171,322	251,132	946	–	1,176,701

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4. SEGMENT INFORMATION *(continued)*

(a) Business segments *(continued)*

Year ended 31 December 2004	Nonferrous metal mine site *RMB'000*	Nonferrous metal smelting *RMB'000*	Cemented carbides, and tungsten, molybdenum, tantalum, niobium and their compounds *RMB'000*	Corporate and others *RMB'000*	Eliminations *RMB'000*	Consolidated *RMB'000*
Continuing operations:						
Segment revenue:						
Sales to external customers	1,078,073	4,377,010	1,874,866	–	–	7,329,949
Intersegment sales	137,729	319	–	–	(138,048)	–
Less: Sales tax and surcharge	(6,957)	(9,498)	(4,520)	–	–	(20,975)
Total	1,208,845	4,367,831	1,870,346	–	(138,048)	7,308,974
Segment results	42,089	559,769	252,370	–	–	854,228
Interest and dividend income						10,206
Finance costs						(148,043)
Share of profits of associates	–	9,311	20,079	–	–	29,390
Profit before tax from continuing operations						745,781
Income tax expense						(95,961)
Net profit for the year from continuing operations						649,820
Discontinued operations:						
Profit for the year from discontinued operations						344
Net profit for the year						650,164
Assets and liabilities						
Segment assets	1,302,432	2,146,852	2,212,370	–	–	5,661,654
Interests in associates	–	410,216	116,028	–	–	526,244
Unallocated assets						106,958
Total assets						6,294,856
Segment liabilities	569,366	637,658	565,069	–	–	1,772,093
Unallocated liabilities						2,652,059
Total liabilities						4,424,152
Other segment information:						
Depreciation and amortisation	44,724	125,972	102,930	–	–	273,626
Capital expenditure	129,501	103,311	292,224	–	–	525,036
Impairment losses recognised in the consolidated income statement, net	–	26	–	–	–	26

4. SEGMENT INFORMATION *(continued)*

(b) Geographical segments

The following tables present revenue and certain asset and expenditure information of continuing operations for the Group's geographical segments for the years ended 31 December 2005 and 2004.

Year ended 31 December 2005	**Mainland China**	**Other Asian countries**	**Others**	**Eliminations**	**Consolidated**
	RMB'000	*RMB'000*	*RMB'000*	*RMB'000*	*RMB'000*
Segment revenue:					
Sales to external customers	7,061,444	2,030,859	242,661	–	9,334,964
Intersegment sales	261,330	–	–	(261,330)	–
Less: Sales tax and surcharge	(43,732)	–	–	–	(43,732)
	7,279,042	2,030,859	242,661	(261,330)	9,291,232
As at 31 December 2005					
Other segment information:					
Segment assets	9,887,440	–	–	–	9,887,440
Interests in associates	39,893	–	–	–	39,893
Unallocated assets					105,079
					10,032,412
Capital expenditure	1,176,701	–	–	–	1,176,701

Notes to Financial Statements
31 December 2005

4. SEGMENT INFORMATION *(continued)*

(b) Geographical segments *(continued)*

Year ended 31 December 2004	Mainland China	Other Asian countries	Others	Eliminations	Consolidated
	RMB'000	*RMB'000*	*RMB'000*	*RMB'000*	*RMB'000*
Segment revenue:					
Sales to external customers	4,797,779	1,862,785	669,385	–	7,329,949
Intersegment sales	138,048	–	–	(138,048)	–
Less: Sales tax and surcharge	(13,863)	(5,232)	(1,880)	–	(20,975)
	4,921,964	1,857,553	667,505	(138,048)	7,308,974
As at 31 December 2004					
Other segment information:					
Segment assets	5,661,654	–	–	–	5,661,654
Interests in associates	526,244	–	–	–	526,244
Unallocated assets					106,958
					6,294,856
Capital expenditure	525,036	–	–	–	525,036

5. REVENUE, OTHER REVENUE AND GAINS

Revenue represents the net invoiced value of goods sold, net of discounts and returns from continuing operations.

An analysis of the Group's other revenue and gains from continuing operations is as follows:

	Notes	**2005** ***RMB'000***	2004 *RMB'000*
Revenue			
Sale of goods		**9,334,964**	7,329,949
Less: Sales tax and surcharge		**(43,732)**	(20,975)
		9,291,232	7,308,974
Other revenue and gains			
Interest income		**10,983**	7,916
Dividend income		**1,404**	2,290
Profit from sale of raw materials		**19,077**	6,074
Profit from sale of utilities		**2,116**	8,149
Gross rental income		**2,806**	7,528
Excess of the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities over the cost on acquisition of a subsidiary	*(i)*	**–**	170,817
Gain on dilution of interest in a subsidiary	*(ii)*	**–**	121,275
Gain on reorganisation of a subsidiary	*(iii)*	**–**	22,426
Gain on disposal of other financial assets, net		**2,523**	–
Government grants	*(iv)*	**13,144**	26,053
Others		**635**	13,134
		52,688	385,662

Notes:

(i) In 2004, Zhuzhou Cemented Carbides Group Corp., Ltd. ("Zhuying"), a subsidiary of the Company, entered into agreements with Guangzhou Zhongkexin Group Company Limited ("Zhongkexin"). Pursuant to these agreements, Zhuying acquired a 98% equity interest in Zhuzhou Diamond Refractory Metal Processing Co., Ltd. ("Diamond Refractory") from Zhongkexin and the consideration was settled by offsetting against the amount receivable from Zhongkexin of RMB100,546,000. The excess of the net fair value of assets, liabilities and contingent liabilities of Diamond Refractory acquired over Zhuying's cost of acquisition of RMB170,817,000 is credited to the Group's consolidated income statement for the year ended 31 December 2004.

In May 2004, Zhuying acquired the remaining 2% equity interest in Diamond Refractory, and Diamond Refractory was then dissolved with its business together with related assets and liabilities being transferred to Zhuying.

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31 December 2005

5. REVENUE, OTHER REVENUE AND GAINS *(continued)*

Notes: (continued)

(ii) Pursuant to the approval from relevant PRC government authorities, Hunan Zhuye Torch Metals Co., Ltd. ("Zhuye Torch"), a then 60.18% owned subsidiary of the Group, was listed on the Shanghai Stock Exchange in August 2004 with new shares issued to the public in the PRC. Subsequent to the issue of the new shares to the public, the Group's effective shareholding interest in Zhuye Torch was diluted from 60.18% to 43.28% and accordingly, a gain on dilution of the Group's interest in Zhuye Torch of RMB121,275,000 was recognised in the consolidated income statement of the Group for the year ended 31 December 2004. Thereafter, Zhuye Torch was accounted for as an associate.

In May 2005, certain shareholders of Zhuye Torch agreed to vote in accordance with Zhuye such that Zhuye secured voting rights exceeding 50% of the voting rights eligible to be cast in the shareholders' meeting of Zhuye Torch and hence Zhuye has regained control over Zhuye Torch. In this regard, Zhuye Torch was consolidated by the Group again in the preparation of the consolidated financial statements starting from 1 June 2005.

Similarly, in May 2005, Zhuying secured more than 50% of the voting rights eligible to cast in the shareholders' meeting of Zhuzhou Diamond by virtue of entering into agreements with certain shareholders of Zhuzhou Diamond pursuant to which they agree to vote in accordance with Zhuying. As such, Zhuying has gained control over Zhuzhou Diamond and Zhuzhou Diamond was consolidated by the Group in the preparation of the consolidated financial statements starting from 1 June 2005.

(iii) As part of the Reorganisation with the effective date of 31 December 2004 as mentioned in note 1 above, COAMC gave up its 48.345% equity interest in Zhuye Nonferrous to Zhuye in exchange for a 36.686% equity interest in Zhuye. As the assets attributed to the Group relating to the 48.345% equity interest in Zhuye Nonferrous acquired by the Group exceeded that of the 36.686% equity interest in Zhuye being disposed of by the Group to COAMC, the excess net assets dealt with in the Group's consolidated financial statements are recognised as a deemed gain on the reorganisation of Zhuye for the year ended 31 December 2004.

(iv) Government grants are as follows:

	The Group	
	2005	2004
	RMB'000	*RMB'000*
Subsidies for the payment of staff salaries and benefits	**7,500**	10,500
Subsidies for business development and recovery of accumulated losses	**1,983**	11,000
Subsidies to encourage export sales	**600**	2,808
Others	**3,061**	1,745
	13,144	26,053

6. PROFIT BEFORE TAX

The Group's profit before tax from continuing operations is arrived at after charging/(crediting):

		The Group	
		2005	2004
	Notes	***RMB'000***	*RMB'000*
Cost of inventories sold		**7,779,944**	6,171,089
Staff costs (including directors', supervisors' and senior executives' remuneration as set out in note 8):			
Wages, salaries and bonuses		**554,521**	386,124
Contribution to defined contribution pension scheme	*(c)*	**99,051**	79,213
Cost of supplementary pension subsidies to retirees and early retirement benefit:	*(d), (e)*		
– current service costs		**–**	3,408
– interest costs		**–**	13,265
– actuarial gains		**–**	(6,958)
		–	9,715
Welfare and other expenses		**122,304**	129,163
		775,876	604,215
Auditors' remuneration*		**3,680**	897
Depreciation	*15*	**304,229**	257,793
Amortisation of lease prepayments	*16*	**12,970**	14,254
Amortisation of intangible assets:	*17*		
Mining rights		**9,232**	–
Technical know-how and others*		**6,083**	1,579
		15,315	1,579
Minimum lease payments under operating leases in respect of land and buildings:			
Lease of land from HNG		**5,042**	–
Lease of land from other parties		**3,821**	447
		8,863	447

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6. PROFIT BEFORE TAX *(continued)*

		The Group	
		2005	2004
	Notes	***RMB'000***	*RMB'000*
Provision for obsolete inventories		**8,153**	4,979
Exchange losses, net*		**701**	80
Research and development costs		**34,473**	20,069
Social function expenses*		**–**	58,869
Donations		**3,534**	4,645
Other operating expenses/(income), net:			
Losses/(gains) on disposal of items of property, plant and equipment		**1,050**	(3,032)
Impairment of property, plant and equipment, net		**–**	26
Provision/(write-back of provision) for doubtful debts on trade and other receivables, net		**(17,357)**	4,386
Losses on disposal of other financial assets, net		–	7,746
Unrealised losses on other financial assets, net		**300**	1,249
Loss on dilution of interest in a subsidiary	*(f)*	**55,630**	–
Others		**1,317**	3,302
		40,940	13,677
Interest income		**(10,983)**	(7,916)
Dividend income		**(1,404)**	(2,290)
Gross rental income		**(1,006)**	(7,528)

* *Items classified under "Administrative expenses" on the face of the consolidated income statement.*

(a) As detailed in note 17 to the consolidated financial statements, the Group obtained the mining rights license from the PRC government free of charge prior to the purchase of the mining rights in September 2005, and hence no amortisation charge thereof was recorded in the Group's consolidated income statement for the period prior to September 2005. The amortisation charge of such mining rights depends on the unit of production of the relevant mines, and the annual amortisation charges of such mining rights determined based on current production level is estimated to be approximately RMB34 million.

(b) In 2005, the Group entered into an agreement with HNG for the lease of lands from HNG at an annual rental of approximately RMB15 million starting from 1 September 2005. Prior to 1 September 2005, such lands were used by the Group free of charge, and hence no rental charges thereof were recorded in the Group's consolidated income statement prior to 1 September 2005.

6. PROFIT BEFORE TAX *(continued)*

(c) All of the Group's full-time employees in the PRC are covered by a government-regulated defined contribution retirement scheme pursuant to which the Group is required to make monthly contributions to the government-regulated retirement scheme at a rate of 20% of the employees' salaries and the PRC government is responsible for the pension liabilities to the Group's current and retired employees. This defined contribution plan continues to be available to the Group's employees after the Reorganisation. The related pension costs are expensed as incurred.

(d) Prior to the Reorganisation, the Group paid certain supplementary pension subsidies to its employees. Such supplementary pension subsidies mainly included living allowances which were payable to employees on a monthly basis after they reached the normal retirement age. The amount of monthly allowances to be paid to the retirees depended on the number of years of service and the policy of the local subsidiaries concerned.

The costs of providing these supplementary pension subsidies are charged to the consolidated income statement of the Group so as to spread the service costs over the average service lives of the employees.

Pursuant to the Reorganisation, HNG agreed to assume the supplementary pension subsidies of the current and retired employees of the Group and the Group agreed to pay RMB303,537,000 (note32) to HNG as consideration, which is payable by instalments over 9 to 16 years, commencing from 1 January 2006. The Group terminated the supplementary pension subsidies attributed to employee services rendered on 1 January 2005 and thereafter.

However, in March 2006, the Group has agreed with HNG that the supplementary pension subsidies obligations previously transferred to HNG should be assumed by the Group again and the Group is no longer liable to settle the outstanding consideration payable to HNG.

The Group has also agreed with HNG to settle the difference between the amount of supplemental pension subsidy paid by HNG to the Group's retirees during 1 January 2005 to 28 February 2006 and the Group's first annual instalment paid to HNG in January 2006 to HNG, and such difference was fully settled among the Group and HNG in March 2006.

(e) The Group implemented early retirement plans (the "Early Retirement Plans") for certain employees in addition to the benefits under the government-regulated defined contribution scheme and the supplementary pension subsidies described in note (c) and note (d) above. The benefits of the Early Retirement Plans are calculated based on factors including the remaining number of years of service from the date of early retirement to the normal retirement date and the salary on the date of early retirement of an employee. The costs of early retirement benefits were recognised in the period when employees opted for early retirement.

Notes to Financial Statements 31 December 2005

6. PROFIT BEFORE TAX *(continued)*

Pursuant to the Reorganisation, HNG agreed to assume all the outstanding obligations under the Group's Early Retirement Plans as at 31 December 2004 and the Group agreed to pay RMB25,912,000 (note 32) to HNG as consideration, which is payable by instalments over 9 to 16 years, commencing from 1 January 2006.

However, in March 2006, the Group has agreed with HNG that the early retirement benefit obligations previously transferred to HNG should be assumed by the Group again and the Group is no longer liable to settle the outstanding consideration payable to HNG. The Group has also agreed with HNG to settle the difference between the amount of early retirement benefits paid by HNG to the Group's early retirees during 1 January 2005 to 28 February 2006 and the Group's first annual instalment paid to HNG in January 2006 to HNG, and such difference was fully settled among the Group and HNG in March 2006.

(f) In October 2005, Zhuye Torch, a subsidiary of the Group with its shares listed in the Shanghai A share market, has approved in its shareholders' meeting to launch a share reform scheme under the requirement of relevant PRC government authorities. Pursuant to the scheme which was completed in November 2005, the Group was required to grant a certain portion of its shares in Zhuye Torch to the other shareholders who held the tradeable shares in Zhuye Torch free of consideration in order to convert the non-tradeable shares in Zhuye Torch held by the Group into tradeable shares. Accordingly, the Group's equity interest in Zhuye Torch was diluted from 31.1% to 26.9% and the dilution loss of RMB56 million (net of minority interests thereof: RMB38 million) attributable to the decrease in the share of the net assets of Zhuye Torch Group was accounted for as a dilution loss in the consolidated income statement for the year ended 31 December 2005.

7. FINANCE COSTS

The Group's finance costs from continuing operations are as follows:

	2005	2004
	RMB'000	*RMB'000*
Interest on bank and other loans wholly repayable within five years	**182,549**	154,697
Less: Amount capitalised as construction in progress	**(8,060)**	(6,654)
	174,489	148,043

8. DIRECTORS' AND SUPERVISORS' REMUNERATION

Details of directors' and supervisors' remuneration for the year, disclosed pursuant to the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited and Section 161 of the Companies Ordinance, are as follows:

	The Group	
	2005	2004
	RMB'000	*RMB'000*
Fees	**117**	–
Salaries, allowances and benefits in kind	**1,460**	960
Performance-related bonuses*	**3,799**	–
Pension scheme contributions	**396**	192
	5,772	1,152

* *Certain executive directors of the Company are entitled to bonus payments which are determined as a percentage of the profit after tax of the Group.*

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8. DIRECTORS' AND SUPERVISORS' REMUNERATION *(continued)*

The names of directors and the supervisors of the Company and their remuneration for the year ended 31 December 2005 are as follows:

	Fees	Salaries, allowances and benefits in kind	Performance-related bonuses	Pension scheme contributions	Total
	RMB'000	*RMB'000*	*RMB'000*	*RMB'000*	*RMB'000*
Executive directors:					
He Renchun	–	133	518	49	700
Li Li	–	107	452	21	580
Liao Luhai	–	87	366	17	470
Chen Zhixin	–	107	413	40	560
	–	434	1,749	127	2,310
Non-executive directors:					
Cao Xiuyun	–	132	522	26	680
Wu Longyun	–	107	392	21	520
Zhang Yixian	–	91	177	32	300
Yu Jiang	–	–	170	–	170
	–	330	1,261	79	1,670
Independent non-executive directors:					
Gu Desheng	33	–	–	–	33
Chan Wai Dune	42	–	–	–	42
Wan Ten Lap	42	–	–	–	42
	117	–	–	–	117
	117	764	3,010	206	4,097
Supervisors:					
Zeng Shaoxiong	–	197	326	57	580
He Hongsen	–	197	266	57	520
Liu Xiaochu	–	–	17	–	17
Jin Liangshou	–	132	67	36	235
He Liu	–	40	16	8	64
Li Junli	–	44	16	9	69
Zhan Yijie	–	86	47	23	156
	–	696	755	190	1,641
Independent supervisors:					
Chen Xiaohong	–	–	17	–	17
Liu Dongrong	–	–	17	–	17
	–	–	34	–	34
	–	696	789	190	1,675
	117	1,460	3,799	396	5,772

8. DIRECTORS' AND SUPERVISORS' REMUNERATION *(continued)*

The names of the directors and supervisors of the Company and their remuneration for the year ended 31 December 2004 are as follows:

	Fees	Salaries, allowances and benefits in kind	Performance-related bonuses	Pension scheme contributions	Total
	RMB'000	*RMB'000*	*RMB'000*	*RMB'000*	*RMB'000*
Executive directors:					
He Renchun	–	23	–	4	27
Li Li	–	421	–	85	506
Liao Luhai	–	–	–	–	–
Chen Zhixin	–	12	–	2	14
	–	456	–	91	547
Non-executive directors:					
Cao Xiuyun	–	480	–	96	576
Wu Longyun	–	–	–	–	–
Zhang Yixian	–	–	–	–	–
Yu Jiang	–	–	–	–	–
	–	480	–	96	576
Independent non-executive directors:					
Gu Desheng	–	–	–	–	–
Chan Wai Dune	–	–	–	–	–
Wan Ten Lap	–	–	–	–	–
	–	–	–	–	–
	–	936	–	187	1,123
Supervisors:					
Zeng Shaoxiong	–	8	–	1	9
He Hongsen	–	8	–	2	10
Liu Xiaochu	–	–	–	–	–
Jin Liangshou	–	5	–	1	6
He Liu	–	–	–	–	–
Li Junli	–	–	–	–	–
Zhan Yijie	–	3	–	1	4
	–	24	–	5	29
Independent supervisors:					
Chen Xiaohong	–	–	–	–	–
Liu Dongrong	–	–	–	–	–
	–	–	–	–	–
	–	24	–	5	29
	–	960	–	192	1,152

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8. DIRECTORS' AND SUPERVISORS' REMUNERATION *(continued)*

There was no arrangement under which a director or a supervisor waived or agreed to waive any remuneration during the year.

9. FIVE HIGHEST PAID EMPLOYEES' REMUNERATION

The five highest paid employees during the year included four directors and supervisors (2004: two), details of whose remuneration are set out in note 8 above. Details of the remuneration of the remaining one (2004: three) non-director and non-supervisor, highest paid employee for the year are as follows:

	The Group	
	2005	2004
	RMB'000	*RMB'000*
Salaries, allowances and benefits in kind	**98**	141
Performance-related bonuses	**395**	1,191
Pension scheme contributions	**98**	266
	591	1,598

The remuneration of the remaining one (2004: three) non-director and non-supervisor, highest paid employee fell within the band of nil to HK$1,000,000.

10. INCOME TAX EXPENSE

The Group is subject to income tax on an entity basis on profits arising in or derived from the jurisdictions in which members of the Group are domiciled and operate.

PRC corporate income tax ("CIT") has been provided at a rate of 33% on the taxable income as reported in the statutory accounts of the companies comprising the Group, which are prepared in accordance with PRC GAAP, as adjusted for income and expense items which are not assessable or deductible for income tax purpose, except for the following subsidiaries of the Company:

(i) Being a sino-foreign investment enterprise, Hunan Diamond Sintered Carbide Tools Company Limited is entitled to (1) a preferential CIT rate of 30%; (2) an exemption from CIT for its first two profitable years which commenced in the year ended 31 December 2002 and a 50% reduction of the CIT rate to 15% for the third to fifth years pursuant to the Income Tax Law of the PRC for Enterprises with Foreign Investment and Foreign Enterprises and the relevant local tax regulations; and (3) a further 50% reduction in the CIT rate to 7.5% for three years, commencing from 1 January 2004 to 31 December 2006, because it is also qualified as a high technology enterprise located in a high technology development zone.

(ii) Shenzhen Jinzhou Jinggong Scientific and Technological Company Limited was subject to a preferential CIT rate of 15% as it is located in the Shenzhen Special Economic Zone.

(iii) Pursuant to the relevant PRC tax regulations, Chenzhou Diamond Tungsten Products Company Limited was exempted from CIT for three years, commencing from 1 January 2004 to 31 December 2006.

Major components of the income tax expenses of continuing operations are as follows:

	The Group	
	2005	2004
	RMB'000	*RMB'000*
The Group:		
PRC corporate income tax		
Charge for the year	**128,670**	83,509
Deferred *(note 21)*	**5,308**	12,452
Total tax charge for the year	**133,978**	95,961

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10. INCOME TAX EXPENSE *(continued)*

A reconciliation of the tax expense applicable to profit before tax using the statutory rate in the PRC in which the Company and the majority of its subsidiaries are domiciled to the tax expense at the effective tax rate, and a reconciliation of the applicable rate (i.e., the statutory tax rate) to the effective tax rates, are as follows:

	The Group			
	2005		2004	
	RMB'000	%	*RMB'000*	%
Profit before tax from continuing operations	**671,233**		745,781	
Tax at the PRC statutory corporate income tax rate of 33%	**221,507**	**33.0**	246,108	33.0
Differential tax rate on the assessable profits/losses of certain subsidiaries	**(12,716)**	**(1.9)**	(4,819)	(0.6)
Tax concessions granted by the tax authorities	**(17,690)**	**(2.6)**	(8,985)	(1.2)
Income tax benefit on locally purchased machinery	**(31,177)**	**(4.6)**	(19,405)	(2.6)
Profits and losses attributable to associates	**(15,713)**	**(2.4)**	(9,699)	(1.3)
Income not subject to tax:				
Gain on acquisition of a subsidiary	**–**	**–**	(56,370)	(7.5)
Dilution gain on disposal of a subsidiary	**–**	**–**	(40,021)	(5.4)
Gain on reorganisation of a subsidiary	**–**	**–**	(7,401)	(1.0)
Others	**(34,497)**	**(5.1)**	(8,041)	(1.1)
Expenses not deductible for tax	**24,264**	**3.6**	4,594	0.6
Total income tax charge for the year	**133,978**	**20.0**	95,961	12.9

The share of tax attributable to associates amounting to RMB13,362,000 (2004: RMB2,222,000) is included in "Share of profits of associates" on the face of the consolidated income statement.

11. NET PROFIT FROM ORDINARY ACTIVITIES ATTRIBUTABLE TO EQUITY HOLDERS OF THE PARENT

The net profit from ordinary activities attributable to equity holders of the parent for the year ended 31 December 2005 dealt with in the financial statements of the Company was RMB81,540,000 (note 36).

12. DISCONTINUED OPERATIONS

Pursuant to the Reorganisation with an effective date of 31 December 2004, the non-core businesses and entities, such as hospitals and schools, historically owned by the Relevant Businesses were transferred to the HNG Group, and the results of such non-core businesses have been included in the consolidated financial statements up to the effective date of the Reorganisation of 31 December 2004 when such non-core businesses and entities were discontinued and transferred to the HNG Group.

The results of such discontinued businesses and entities for the year ended 31 December 2004 are separately disclosed on the face of the consolidated income statement and are analysed below:

	RMB'000
Other income	79,018
Administration expenses	(78,674)
Profit for the year from discontinued operations	344

Other income generated by the discontinued businesses and entities disclosed in the above table included the social function subsidy income of RMB58,869,000 received from the Group's continuing operations during the year ended 31 December 2004.

The assets and liabilities of the discontinued businesses and entities as at 31 December 2004 were included as part of the assets and liabilities distributed to the HNG Group as disclosed in note 38(e) to the consolidated financial statements.

The net cash flows attributable to the discontinued businesses for the year ended 31 December 2004 are as follows:

	RMB'000
Operating activities	(1,972)
Investing activities	(19)
Net cash outflow	(1,991)
Additional information:	
Depreciation	22,926
Capital expenditure	67

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13. SPECIAL DIVIDEND

In March 2006, the directors proposed to declare a special dividend amounting to RMB230,980,000 to HNG. This was approved in the shareholders' meeting held in the same month. As the dividend was declared after the last balance sheet date of 31 December 2005, it has not been recognised as a liability as at 31 December 2005. The directors resolved not to declare any final dividend for the year ended 31 December 2005 (2004: nil).

14. EARNINGS PER SHARE ATTRIBUTABLE TO ORDINARY EQUITY HOLDERS OF THE PARENT

The calculation of basic earnings per share is based on:

	2005	2004
	RMB'000	*RMB'000*
Earnings		
Net profit for the year attributable to equity holders of the parent	**426,013**	555,210

	Number of shares	
	'000	*'000*
Shares		
Weighted average number of shares in issue during the year	**2,114,575**	2,091,260

The Company's weighted average number of shares in issue during the year ended 31 December 2004 and 2005 used in the basic earnings per share calculation is determined on the assumption that the 2,091,260,000 domestic shares of RMB1 each issued as a result of the Reorganisation had been in issue throughout the years ended 31 December 2004 and 2005 and as adjusted to add the 92,500,000 domestic shares of RMB1 each issued to the Other Promoters in September 2005 upon the incorporation of the Company. Further details of the Reorganisation are set out in note 1 to the consolidated financial statements.

No diluted earnings per share amount has been disclosed as no diluting events existed during the year.

15. PROPERTY, PLANT AND EQUIPMENT

The Group

	Buildings and mining structures *RMB'000*	Plant, machinery and equipment *RMB'000*	Construction in progress *RMB'000*	Total *RMB'000*
31 December 2005				
At 31 December 2004 and at 1 January 2005:				
Cost	1,506,464	2,030,491	163,493	3,700,448
Accumulated depreciation and impairment	(487,901)	(931,451)	(575)	(1,419,927)
Net carrying amount	1,018,563	1,099,040	162,918	2,280,521
At 1 January 2005, net of accumulated depreciation and impairment	1,018,563	1,099,040	162,918	2,280,521
Additions	2,525	128,864	396,327	527,716
Interest capitalised	–	–	8,060	8,060
Consolidation of subsidiaries *(note 37(a))*	321,273	549,733	60,295	931,301
Disposals	(20,652)	(19,790)	(4,771)	(45,213)
Depreciation provided during the year	(76,809)	(227,420)	–	(304,229)
Transfers	23,506	226,063	(249,569)	–
At 31 December 2005, net of accumulated depreciation and impairment	1,268,406	1,756,490	373,260	3,398,156
At 31 December 2005:				
Cost	2,019,888	3,290,890	373,835	5,684,613
Accumulated depreciation and impairment	(751,482)	(1,534,400)	(575)	(2,286,457)
Net carrying amount	1,268,406	1,756,490	373,260	3,398,156

Notes to Financial Statements 31 December 2005

15. PROPERTY, PLANT AND EQUIPMENT *(continued)*

The Group

	Buildings and mining structures *RMB'000*	Plant, machinery and equipment *RMB'000*	Construction in progress *RMB'000*	Total *RMB'000*
31 December 2004				
At 1 January 2004:				
Cost	2,144,103	2,316,080	412,038	4,872,221
Accumulated depreciation and impairment	(812,591)	(1,245,888)	(575)	(2,059,054)
Net carrying amount	1,331,512	1,070,192	411,463	2,813,167
At 1 January 2004, net of accumulated depreciation and impairment	1,331,512	1,070,192	411,463	2,813,167
Additions	11,328	162,340	327,582	501,250
Interest capitalised	–	–	6,654	6,654
Contribution from the HNG Group *(note 38(a))*	–	12,987	–	12,987
Acquisition of a subsidiary *(note 37(a))*	–	115,386	42,942	158,328
Deconsolidation of a subsidiary *(note 37(b))*	(279,852)	(307,392)	(30,134)	(617,378)
Disposals	(29,613)	–	(3,604)	(33,217)
Capital reduction of a subsidiary *(note 38(d))*	(31,854)	(13,811)	–	(45,665)
Distributions *(note 38(e))*	(142,255)	(44,110)	(48,495)	(234,860)
Impairment during the year	–	(2,508)	–	(2,508)
Reversal of impairment during the year	684	1,798	–	2,482
Depreciation provided during the year	(107,282)	(173,437)	–	(280,719)
Transfers	265,895	277,595	(543,490)	–
At 31 December 2004, net of accumulated depreciation and impairment	1,018,563	1,099,040	162,918	2,280,521
At 31 December 2004:				
Cost	1,506,464	2,030,491	163,493	3,700,448
Accumulated depreciation and impairment	(487,901)	(931,451)	(575)	(1,419,927)
Net carrying amount	1,018,563	1,099,040	162,918	2,280,521

15. PROPERTY, PLANT AND EQUIPMENT *(continued)*

The Company

	Buildings and mining structures *RMB'000*	Plant, machinery and equipment *RMB'000*	Construction in progress *RMB'000*	Total *RMB'000*
31 December 2005				
Transferred from HNG in connection with the Reorganisation:	52,508	13,636	58	66,202
Additions	60	9,759	1,108	10,927
Depreciation provided during the year	(6,141)	(7,051)	–	(13,192)
Disposals	–	(9)	–	(9)
At 31 December 2005, net of accumulated depreciation	46,427	16,335	1,166	63,928
At 31 December 2005:				
Cost	121,272	74,869	1,166	197,307
Accumulated depreciation	(74,845)	(58,534)	–	(133,379)
Net carrying amount	46,427	16,335	1,166	63,928

At 31 December 2005, certain of the Group's buildings and mining structures, plant, machinery and equipment, which had an aggregate net book value of approximately RMB1,019,504,000 (2004: RMB527,595,000) were pledged to secure bank loans granted to the Group (note 31).

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16. LEASE PREPAYMENTS

The Group

	2005 RMB'000	2004 RMB'000
Carrying amount at 1 January	**751,151**	749,191
Additions	**18,000**	6,421
Consolidation of subsidiaries *(note 37(a))*	**19,302**	–
Contribution from the HNG Group *(note 38(a))*	**–**	80,230
Acquisition by a non-cash consideration *(note 38(b))*	**–**	3,490
Disposal by a non-cash consideration *(note 38(c))*	**–**	(10,920)
Disposals	**–**	(1,848)
Distributions *(note 38(e))*	**–**	(61,159)
Amortisation during the year	**(12,970)**	(14,254)
Carrying amount at 31 December	**775,483**	751,151

The Company

	2005 RMB'000
Transferred from HNG in connection with the Reorganisation *(note 38(a))*	**80,230**
Amortisation during the year	–
Carrying amount at 31 December	**80,230**

The leasehold land is held under a 50-year lease and is situated in the PRC.

As at 31 December 2005, certain of the Group's bank loans were secured by certain of the Group's lease prepayments, which had an aggregate net carrying amount of RMB284,907,000 (2004: RMB268,561,000) (note 31).

In 2005, the Group entered into an agreement with HNG for the lease of lands from HNG at an annual rental of approximately RMB15 million starting from 1 September 2005. Prior to 1 September 2005, such lands were used by the Group free of charge.

17. INTANGIBLE ASSETS

The Group

	Mining rights RMB'000	Technical know-how RMB'000	Others RMB'000	Total RMB'000
31 December 2005:				
At 1 January 2005:				
Cost	–	7,661	6,699	14,360
Accumulated amortisation	–	(752)	(1,569)	(2,321)
Net carrying amount	–	6,909	5,130	12,039
At 1 January 2005, net of accumulated amortisation	–	6,909	5,130	12,039
Additions	608,553	12,319	2,053	622,925
Consolidation of subsidiaries *(note 37(a))*	–	3,998	3,662	7,660
Amortisation provided during the year	(9,232)	(2,265)	(3,818)	(15,315)
At 31 December 2005	599,321	20,961	7,027	627,309
At 31 December 2005:				
Cost	608,553	25,607	17,057	651,217
Accumulated amortisation	(9,232)	(4,646)	(10,030)	(23,908)
Net carrying amount	599,321	20,961	7,027	627,309
31 December 2004:				
At 1 January 2004:				
Cost	–	701	6,452	7,153
Accumulated amortisation	–	(155)	(587)	(742)
Net carrying amount	–	546	5,865	6,411
Cost at 1 January 2004, net of accumulated amortisation	–	546	5,865	6,411
Additions	–	6,960	328	7,288
Deconsolidation of a subsidiary *(note 37(b))*	–	–	(81)	(81)
Amortisation provided during the year	–	(597)	(982)	(1,579)
At 31 December 2004	–	6,909	5,130	12,039
At 31 December 2004 and at 1 January 2005:				
Cost	–	7,661	6,699	14,360
Accumulated amortisation	–	(752)	(1,569)	(2,321)
Net carrying amount	–	6,909	5,130	12,039

Notes to Financial Statements
31 December 2005

17. INTANGIBLE ASSETS *(continued)*

The Company

31 December 2005	**Mining rights**
	RMB'000
Addition	100,171
Amortisation provided during the year	(2,877)
At 31 December 2005	97,294
At 31 December 2005:	
Cost	100,171
Accumulated amortisation	(2,877)
Net carrying amount	97,294

In accordance with relevant PRC government regulations, the Group is required to acquire the mining rights for certain consideration if it undergoes a reorganisation. Accordingly, pursuant to the Reorganisation for the purposes of the listing of the Company's shares on The Stock Exchange of Hong Kong Limited, the Group purchased the mining rights from the PRC government in September 2005 for an aggregate cash consideration of RMB609 million, of which RMB25 million was paid during the year. The remaining balance will be paid within six years.

Prior to the purchase of the mining rights in September 2005, the Group has obtained the mining right license from the PRC government to conduct mining activities free of charge, except for certain mining fees, levies and taxes which are payable on an ongoing basis.

The cash outflow in respect of additions to intangible assets for the year ended 31 December 2005 is analyzed as follows:

	2005
	RMB'000
Purchase of mining rights	**25,000**
Purchase of technical know-how	**12,319**
Other purchases	**2,053**
	39,372

18. INTERESTS IN SUBSIDIARIES

The Company

	2005 RMB'000
Unlisted investments, at cost	800,442
Due from a subsidiary	13,500
	813,942

The amount due from a subsidiary is unsecured, interest-free and has no fixed terms of repayment.

Particulars of the principal subsidiaries are as follows:

Name	Place of incorporation/ establishment and operations	Nominal value of paid-up/ registered capital (in thousands)	Percentage of equity interests attributable to the Company Direct %	Indirect %	Principal activities
Zhuzhou Cemented Carbides Group Corp., Ltd. (株洲硬質合金集團有限公司)	Mainland China	RMB535,761	99	–	Manufacture of hard alloys and refractory metal compounds
Zhuzhou Smelter Group Co., Ltd (株洲冶煉集團有限責任公司)	Mainland China	RMB872,888	63.314	–	Smelting of nonferrous metals
Hsikwangshan Twinkling Star Antimony Co., Ltd. (錫礦山閃星銻業有限責任公司)	Mainland China	RMB154,710	75.58	–	Mining and smelting of nonferrous metals
Hunan Shizhuyuan Nonferrous Metals Co., Ltd. (湖南柿竹園有色金屬有限責任公司)	Mainland China	RMB106,992	79	–	Mining of nonferrous metals
Hunan Zhuye Torch Metals Co., Ltd.* (湖南株冶火炬金屬股份有限公司)	Mainland China	RMB427,458	4.043	22.81	Smelting of zinc products
Shanghai Jinhuoju Metals Ltd.* (上海金火炬金屬有限公司)	Mainland China	RMB1,500	–	26.80	Trading of metal ingots
Foshan City Nanhai Jinhuoju Metals Ltd.* (佛山市南海金火炬金屬有限公司)	Mainland China	RMB3,000	–	26.80	Trading of metal ingots

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18. INTERESTS IN SUBSIDIARIES *(continued)*

Name	Place of incorporation/ establishment and operations	Nominal value of paid-up/ registered capital *(in thousands)*	Percentage of equity interests attributable to the Company Direct %	Indirect %	Principal activities
Chenzhou Huoju Kuangye Ltd.* (郴州火炬礦業有限責任公司)	Mainland China	RMB2,000	–	26.80	Trading of metal ingots
Hunan Zhuye Torch Metals Import and Export Company Limited* (湖南株冶火炬金屬進出口有限公司)	Mainland China	RMB80,000	–	26.52	Export and import of commercial products and technology
Torch Metals Limited ("Hong Kong Torch")* (火炬金屬有限公司)	Hong Kong	HK$5,000	–	44.32	Trading of metal ingots
Torch Zinc Limited* (火炬鋅業有限公司)	Hong Kong	US$100	–	23.87	Trading of metal ingots
Zengke Hejin (Shenzhen) Ltd* (鋥科合金(深圳)有限公司)*	Mainland China	US$1,550	–	44.32	Manufacture of metal ingots
Zhuzhou Quanxin Industry Co., Ltd. (株洲全鑫實業有限公司)	Mainland China	RMB64,600	–	58.29	Manufacture of metal ingots
Shanghai Zhuye Nonferrous Metals Co., Ltd. (上海株冶有色金屬有限公司)	Mainland China	RMB1,000	–	56.98	Trading of metal ingots
Foshan City Nanhai Zhuye Nonferrous Metals Co., Ltd. (佛山市南海株冶金屬有限公司)	Mainland China	RMB1,000	–	56.98	Trading of metal ingots
ZCC Import and Export Company Limited (株洲硬質合金進出口公司)	Mainland China	RMB30,000	–	98.6	Import and export of metal compounds
Hunan Diamond Sintered Carbide Tools Company Limited* (湖南鉆石硬質合金工具有限公司)	Mainland China	US$9,800	–	26.68	Manufacture of hard alloy products
Chenzhou Diamond Tungsten Products Company Limited (郴州鉆石鎢制品有限責任公司)	Mainland China	RMB60,000	–	91	Manufacture of chemical products

18. INTERESTS IN SUBSIDIARIES *(continued)*

Name	Place of incorporation/ establishment and operations	Nominal value of paid-up/ registered capital	Percentage of equity interests attributable to the Company Direct	Indirect	Principal activities
		(in thousands)	%	%	
Shenzhen Jinzhou Jinggong Scientific and Technological Company Limited* (深圳市金洲精工科技股份有限公司)	Mainland China	RMB61,109	–	49.50	Manufacture of metal and alloy products
Zhuzhou Diamond Cutting Tools Company Limited* (株洲鉆石切削刀具股份有限公司)	Mainland China	RMB200,000	–	41.78	Manufacture of metal and alloy products

* *These companies are controlled by the non wholly-owned subsidiaries of the Company and accordingly, they are accounted for as subsidiaries by virtue of the Group's control over them.*

The above table lists the subsidiaries of the Company which, in the opinion of the directors, principally affected the results for the year or formed a substantial portion of the net assets of the Group. To give details of other subsidiaries would, in the opinion of the directors, result in particulars of excessive length.

19. INTERESTS IN ASSOCIATES

	The Group	
	2005	2004
	RMB'000	*RMB'000*
Share of net assets of associates	**35,174**	487,707
Due from associates	**6,774**	52,400
Due to associates	**(2,055)**	(13,863)
	39,893	526,244

The balances with the associates are unsecured, interest-free and repayable according to normal terms.

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19. INTERESTS IN ASSOCIATES *(continued)*

Particulars of the principal associate are as follows:

Name	Place of incorporation/ establishment and operations	Nominal value of paid-up/ registered capital	Percentage of equity interests attributable to the Company		Principal activity
			Direct	Indirect	
		(in thousands)	%	%	
Zhuzhou Changjiang Cemented Carbides Tools Company Limited ("Zhuzhou Changjiang") (株洲長江硬質合金工具有限公司)	Mainland China	RMB38,832	–	45.89	Manufacture of metal and alloy products

In the opinion of the directors, the above associate of the Group principally affected the results for the year or formed a substantial portion of the net assets of the Group. To give details of other associates would, in the opinion of the directors, result in particulars of excessive length.

The aggregate amounts of the assets, liabilities, revenue and profit of the associates attributable to the Group are as follows:

	2005	2004
	RMB'000	*RMB'000*
Total assets	**97,292**	1,267,798
Total liabilities	**57,399**	741,554
Net assets	**39,893**	526,244
Total revenues	**985,805**	728,909
Profit attributable to the Group	**47,660**	29,390

20. AVAILABLE-FOR-SALE FINANCIAL ASSETS

The Group

	2005	2004
	RMB'000	*RMB'000*
Unlisted equity investments, at cost	**19,567**	14,374

The unlisted equity investments comprise certain associates and subsidiaries which are individually and in aggregate not material to the Group's financial position and results of operations for the year. The fair values of unlisted equity investments cannot be reliably measured and the Group accounted for these interests at cost less provision for impairment losses.

21. DEFERRED TAX ASSETS

The movements in deferred tax assets during the year are as follows:

	The Group		The Company
	2005	2004	**2005**
	RMB'000	*RMB'000*	***RMB'000***
At 1 January	**62,582**	85,563	**–**
Transferred from HNG in connection with the Reorganisation	**–**	–	**5,344**
Deferred tax credited to the consolidated income statement during the year *(note 10)*	**(5,308)**	(12,452)	**(2,338)**
Dilution of interest in Zhuye Torch *(Note (a))*	**–**	(10,529)	**–**
Deferred tax assets at 31 December	**57,274**	62,582	**3,006**

Note:

(a) The Group's equity interest in Zhuye Torch was diluted from 60.18% to 43.28% in August 2004 and thereafter Zhuye Torch became an associate of the Group. The unrealized gain on property, plant and equipment purchased by Zhuye Torch from the Group dealt with in the Group's consolidated financial statements prior to the dilution of equity interest in Zhuye Torch was hence realised to the extent of equity interest held by the outside minority shareholders of Zhuye Torch. Accordingly, the deferred tax assets relating to such unrealised gain previously recognised for the property, plant and equipment of Zhuye Torch were reversed from the Group's consolidated financial statements to the extent of the deferred tax assets relating to such gain realised upon such dilution of equity interest in Zhuye Torch.

(b) The recognition of deferred tax assets is attributable to the following items:

	The Group		The Company
	2005	2004	**2005**
	RMB'000	*RMB'000*	***RMB'000***
Accelerated depreciation for tax purposes	**54,268**	57,237	**–**
Other temporary differences	**3,006**	5,345	**3,006**
	57,274	62,582	**3,006**

The Group has tax losses arising in the Mainland China of RMB790,654 (2004: Nil) that are available for offsetting against future taxable profits of the companies in which the losses arose. Deferred tax assets have not been recognised in respect of these losses as the amount is immaterial.

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22. INVENTORIES

	The Group		The Company
	2005	2004	**2005**
	RMB'000	*RMB'000*	***RMB'000***
Raw materials	**933,036**	370,395	**10,352**
Work in progress	**977,687**	587,094	**–**
Finished goods	**898,473**	386,908	**3,069**
	2,809,196	1,344,397	**13,421**
Less: Provision for obsolete inventories	**(22,411)**	(6,087)	**–**
	2,786,785	1,338,310	**13,421**

23. TRADE RECEIVABLES

The Group normally allows a credit period of one month to customers with an established trading history; otherwise, cash terms are normally required.

An aged analysis of the trade receivables as at the balance sheet date, based on the invoice date, is as follows:

	The Group		The Company
	2005	2004	**2005**
	RMB'000	*RMB'000*	***RMB'000***
Within 1 year	**236,338**	297,640	**4,300**
Over 1 year but within 2 years	**8,255**	15,514	**40**
Over 2 years but within 3 years	**6,207**	10,349	**–**
Over 3 years	**18,944**	9,091	**7,150**
	269,744	332,594	**11,490**
Less: Provision for doubtful debts	**(34,914)**	(30,368)	**(7,377)**
	234,830	302,226	**4,113**

The amount due from the HNG Group of RMB1,173,000 as at 31 December 2004 included in the Group's trade receivables was unsecured, interest-free and was fully settled during 2005.

24. BILLS RECEIVABLE

	The Group		The Company
	2005	2004	**2005**
	RMB'000	*RMB'000*	***RMB'000***
Within 120 days	**103,383**	36,936	**1,870**
Over 121 days but within 1 year	**74,890**	33,972	**100**
	178,273	70,908	**1,970**

25. PREPAYMENTS, DEPOSITS AND OTHER RECEIVABLES

	The Group		The Company
	2005	2004	**2005**
	RMB'000	*RMB'000*	***RMB'000***
Prepayments,deposits and other receivables from:			
– the HNG Group	**182,060**	16,773	**61,010**
– third parties	**706,847**	509,646	**37,386**
	888,907	526,419	**98,396**
Less: Provision for doubtful debts	**(31,718)**	(43,954)	**–**
	857,189	482,465	**98,396**

The amount receivable from the HNG Group was unsecured, interest-free and repayable on demand.

26. OTHER FINANCIAL ASSETS

	The Group		The Company
	2005	2004	**2005**
	RMB'000	*RMB'000*	***RMB'000***
Held for trading purposes, at market value:			
Listed equity investments	**2,000**	339	**–**
Listed debt investments	**24,598**	29,609	**24,398**
	26,598	29,948	**24,398**

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27. CASH AND CASH EQUIVALENTS AND PLEDGED DEPOSITS

	The Group		The Company
	2005	2004	**2005**
	RMB'000	*RMB'000*	***RMB'000***
Cash and bank balances	**752,598**	369,838	**58,812**
Time deposits	**276,817**	54,196	**71,390**
	1,029,415	424,034	**130,202**
Less: Pledged cash and time deposits against trade finance facilities	**(24,273)**	(51,746)	**(4,750)**
Cash and cash equivalents in the balance sheet	**1,005,142**	372,288	**125,452**
Less: Non-pledged time deposits with original maturity of three months or more when acquired	**(207,496)**	–	**(20,680)**
Cash and cash equivalents in the cash flow statement	**797,646**	372,288	**104,772**

Cash at banks earns interest at floating rates based on daily bank deposit rates. Short term time deposits are made for varying periods of between one day and three months depending on the immediate cash requirements of the Group, and earn interest at the respective short term time deposit rates.

28. TRADE PAYABLES

An aged analysis of the trade payables as at the balance sheet date, based on the invoice date, is as follows:

	The Group		The Company
	2005	2004	**2005**
	RMB'000	*RMB'000*	***RMB'000***
Within 1 year	**650,630**	399,244	**10,903**
Over 1 year but within 2 years	**18,409**	3,020	**–**
Over 2 years but within 3 years	**7,025**	2,168	**–**
Over 3 years	**2,251**	4,484	**–**
	678,315	408,916	**10,903**

28. TRADE PAYABLES *(continued)*

The amount due to the HNG Group of RMB19,169,000 (2004: RMB3,987,000) as at 31 December 2005 included in the Group's trade payables was unsecured, interest-free and repayable within trade credit periods.

29. BILLS PAYABLE

	The Group		The Company
	2005	2004	**2005**
	RMB'000	*RMB'000*	***RMB'000***
Within 120 days	**59,049**	120,200	**1,049**
Over 121 days but within 1 year	**25,500**	126,440	**–**
	84,549	246,640	**1,049**

Certain of the Group's cash and time deposits amounting to RMB18,731,000 and RMB50,403,000 as at 31 December 2005 and 2004, respectively, were pledged to banks for the issuance of bank acceptance notes.

As at 31 December 2005, the Company had deposits of RMB4,750,000 pledged to banks for the issuance of bank acceptance notes.

30. OTHER PAYABLES AND ACCRUALS

Other payables are non-interest-bearing and have no fixed terms of repayment.

Included in other payables and accruals of the Group are balances due to the HNG Group of RMB3,036,000 and RMB102,645,000 as at 31 December 2004 and 2005, respectively.

Included in other payables and accruals of the Company are balances due to the HNG Group of RMB5,967,000.

The amounts due to the HNG Group were unsecured, interest-free and repayable on demand.

Included in other payables and accruals of the Group and Company as at 31 December 2005 is the current portion of other payables in connection with the purchase of mining rights (note 33) of RMB76,426,000 and RMB12,445,000, respectively.

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31. INTEREST-BEARING BANK AND OTHER BORROWINGS

	Effective interest rate (%)	Maturity	The Group 2005 RMB'000	2004 RMB'000
Current				
Bank loans – unsecured	LIBOR+1.05	2006	**48,325**	–
Bank loans – unsecured	3.88 – 6.63	2006	**2,217,522**	1,488,428
Bank loans – secured	LIBOR+1.29	2006	**40,270**	–
Bank loans – secured	HIBOR+0.5	2006	**5,217**	–
Bank loans – secured	3.88 – 7.25	2006	**932,127**	617,290
Other borrowings				
– unsecured	3.88 – 5.86	2006	**52,000**	24,500
			3,295,461	2,130,218
Non-current				
Bank loans – unsecured	3.78 – 6.63	2007 – 2010	**652,100**	141,842
Bank loans – secured	3.78 – 7.49	2007 – 2010	**57,000**	296,400
Other borrowings				
– unsecured	2.10 – 2.88	2007 – 2023	**11,732**	27,355
			720,832	465,597
			4,016,293	2,595,815

31. INTEREST-BEARING BANK AND OTHER BORROWINGS *(continued)*

	The Group	
	2005	2004
	RMB'000	*RMB'000*
Analysed into:		
Bank loans repayable:		
Within one year or on demand	**3,243,461**	2,105,718
In the second year	**261,000**	335,036
In the third to fifth years, inclusive	**448,100**	89,000
Beyond five years	**–**	14,206
	3,952,561	2,543,960
Other borrowings repayable:		
Within one year	**52,000**	24,500
In the second year	**–**	14,187
In the third to fifth years, inclusive	**–**	800
Beyond five years	**11,732**	12,368
	63,732	51,855
	4,016,293	2,595,815

Note:

Certain of the Group's bank loans are secured by mortgages over the Group's property, plant and equipment and lease prepayments, which had an aggregate carrying value at the balance sheet date of approximately RMB$1,304,411,000 (2004: RMB796,156,000);

As at 31 December 2005, HNG has guaranteed certain of the Group's bank loans to the extent of RMB328,000,000 (2004: RMB100,000,000) and such guarantees were released by the lending bank subsequent to 31 December 2005.

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32. OTHER LIABILITIES

The other liabilities represented the amounts due to the HNG Group and the details are as follows:

	The Group		The Company
	2005	2004	**2005**
	RMB'000	*RMB'000*	***RMB'000***
Due to the HNG Group:			
Transfer from provision for supplementary pension subsidies and early retirement benefits at 31 December 2004 *(note (i))*	**329,449**	329,449	**50,602**
Distribution to the HNG Group *(note (ii))*	**60,686**	60,686	**–**
Balance as at 31 December	**390,135**	390,135	**50,602**
Represented by:			
Current portion included in other payables and accruals	**90,937**	–	**5,967**
Long term liabilities	**299,198**	390,135	**44,635**
	390,135	390,135	**50,602**

Notes:

(i) The supplementary pension subsidies and early retirement benefits payable by the Group and the Company to HNG of RMB329,449,000 and RMB50,602,000 respectively are payable by instalments over 9 to 16 years, commencing from 1 January 2006.

In March 2006, the supplementary pension subsidies and early retirement benefits obligations have been transferred back to the Group and the Group is no longer liable to settle any outstanding amount payable to HNG. Further details are set out in note 6(d) to the consolidated financial statements.

(ii) Pursuant to an approval document from relevant government authorities, Zhuye reduced its capital by RMB106,351,000 and the proceeds from the reduction of capital will be paid back to the HNG Group. Out of the proceeds of RMB106,351,000, RMB45,665,000 was settled through the transfer of property, plant and equipment to the HNG Group at 31 December 2004 and the remaining balance of RMB60,686,000 was settled in February 2006.

33. PAYABLES FOR MINING RIGHTS

	The Group		The Company
	2005	2004	**2005**
	RMB'000	*RMB'000*	***RMB'000***
Payables in connection with the purchase of mining rights	**583,554**	–	**95,921**
Less: Portion classified as current liabilities *(note 30)*	**(76,426)**	–	**(12,445)**
Long term liabilities	**507,128**	–	**83,476**

The consideration for the purchase of the mining rights is payable to the relevant government authority over six years by annual instalments commencing from September 2005.

34. GOVERNMENT GRANTS

	The Group		The Company
	2005	2004	**2005**
	RMB'000	*RMB'000*	***RMB'000***
At beginning of year	**18,853**	30,820	**–**
Received during the year	**43,827**	18,387	**100**
Consolidation/acquisition of subsidiaries *(note 37(a))*	**15,000**	699	**–**
Recognised as other revenue and gains during the year	**(13,144)**	(26,053)	**–**
Deconsolidation of a subsidiary *(note 37(b))*	**–**	(5,000)	**–**
At end of year	**64,536**	18,853	**100**

35. SHARE CAPITAL

The Group and the Company

	Number of shares	Nominal value
	2005	**2005**
	'000	*RMB'000*
Registered, issued and fully paid:		
– domestic shares of RMB1.00 each	2,183,760	2,183,760

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35. SHARE CAPITAL *(continued)*

The Company was incorporated on 1 September 2005 with a registered share capital of RMB2,183,760,000, divided into 2,183,760,000 domestic shares with a par value of RMB1.00. The Company issued 2,091,260,000 domestic shares to HNG credited as fully paid in consideration for the transfer of the Relevant Businesses by HNG to the Company pursuant to the Reorganisation referred to in note 1 to the consolidated financial statements. The remaining 92,500,000 domestic shares of the Company were issued to Other Promoters at par value for cash.

Details of the issuance of new H shares subsequent to 31 December 2005 are set out in note 1 and notes 44(c) and (d) to the consolidated financial statements.

36. RESERVES

The Group

The amount of the Group's reserves and the movements therein for the current and prior years are presented in the consolidated statement of changes in equity on page 45 of the consolidated financial statements.

The Company

	Capital reserve	**Statutory reserves**	**Proposed dividend**	**Accumulated losses**	**Total**
	RMB'000	*RMB'000*	*RMB'000*	*RMB'000*	*RMB'000*
Capitalisation as a result of the Reorganisation *(note (a))*	(1,178,319)	–	–	–	(1,178,319)
Net profit for the year	–	–	–	81,540	81,540
Transfer to reserves *(note (b))*	–	73,946	–	(73,946)	–
Proposed dividend	–	–	230,980	(230,980)	–
At 31 December 2005	(1,178,319)	73,946	230,980	(223,386)	(1,096,779)

Notes:

(a) As described in note 1 to the consolidated financial statements, the consolidated financial statements of the Group for the years ended 31 December 2004 and 2005 have been prepared as if the Group had been in existence at the beginning of the year ended 31 December 2004. Upon the incorporation of the Company on 1 September 2005, the historical net asset value of the Relevant Businesses was converted into the Company's registered capital as described in note 1 to the consolidated financial statements with all the then existing reserves eliminated and the resulting difference dealt with in the capital reserve. Accordingly, a capital reserve, being the difference between the amount of share capital issued and the historical net asset value of the Relevant Businesses transferred to the Company as at the effective date of 31 December 2004, was presented in the reserves of both the Group and the Company. Separate classes of reserves, including retained profits of the Group prior to 31 December 2004, were not separately disclosed as all of these reserves had been capitalised and incorporated in the capital reserve of the Group and the Company pursuant to the Reorganisation.

36. RESERVES *(continued)*

The Company *(continued)*

Notes: (continued)

(b) In accordance with the articles of association of the Company approved by the relevant government authorities on 30 September 2005, the net profit after tax of the Company for the purpose of profit distribution will be deemed to be the lesser of (i) the net profit determined in accordance with PRC GAAP and (ii) the net profit determined in accordance with IFRSs. Under the PRC Company law and the Company's articles of association, net profit after tax can only be distributed as dividends after an allowance has been made for the following:

(i) Making up prior years' cumulative losses, if any.

(ii) Allocations to the statutory common reserve fund of at least 10% of after-tax profit, until the fund aggregates 50% of the Company's share capital. For the purpose of calculating the transfer to reserves, the profit after tax shall be the amount determined under PRC GAAP. The transfer to this reserve must be made before any distribution of dividends to shareholders.

The statutory common reserve fund can be used to offset previous years' losses, if any, and part of the statutory common reserve fund can be capitalised as the Company's share capital provided that the amount of such reserve remaining after the capitalisation shall not be less than 25% of the share capital of the Company.

(iii) Allocations of 5% to 10% of after-tax profit, as determined under PRC GAAP, to the Company's statutory public welfare fund, which is established for the purpose of providing collective welfare benefits to the Company's employees such as the construction of dormitories, canteens and other staff welfare facilities. The fund forms part of the shareholders' equity as individual employees can only use these facilities, while the title of such facilities is held by the Company. The transfer to this fund must be made before any distribution of dividends to shareholders.

(iv) Allocations to the discretionary common reserve if approved by the shareholders.

The above reserves cannot be used for purposes other than those for which they are created and are not distributable as cash dividends.

Prior to the approval of the Company's articles of association by relevant government authorities on 30 September 2005, the net profit after tax of the Company for the purpose of profit distribution was determined based on the net profit under PRC GAAP and after the aforesaid allowance has been made.

During the year, the directors have approved the appropriation of RMB36,973,000 and RMB 36,973,000 to the statutory common reserve fund and the statutory public welfare fund respectively, each of which represented 10% of the net profit of the Company for the year ended 31 December 2005 of RMB369,729,000 as determined under PRC GAAP. However, the appropriation to the statutory public welfare fund is subject to the approval of the Company's shareholders.

For dividend purposes, the amount which the Company's subsidiaries can legally distribute by way of a dividend is determined with reference to their profits available for distribution as reflected in their respective PRC statutory financial statements which are prepared in accordance with PRC GAAP. These profits differ from those reflected in this report which is prepared in accordance with IFRSs.

After the payment of a special dividend of RMB230,980,000 (Note 13) in March 2006, the Company has no retained profits available for distribution.

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37. BUSINESS COMBINATIONS

(a) Acquisition/consolidation of subsidiaries

The fair value/carrying value of the identifiable assets, liabilities and contingent liabilities of the subsidiaries acquired/consolidated by the Group and dealt with in the consolidated financial statements at the dates of acquisition/consolidation were as follows:

	2005	2004
	RMB'000	*RMB'000*
	(note (i))	*(note (ii))*
Property, plant and equipment	**931,301**	158,328
Lease prepayments	**19,302**	–
Intangible assets	**7,660**	–
Inventories	**816,318**	65,013
Trade receivables	**109,466**	198,394
Bills receivable	**99,832**	33,100
Prepayments, deposits and other receivables	**216,412**	14,020
Tax recoverable	**1,140**	–
Pledged deposits	**56,081**	–
Cash and cash equivalents	**450,875**	38,788
Trade payables	**(179,362)**	(53,168)
Bills payable	**(31,783)**	–
Other payables and accruals	**(215,986)**	(52,232)
Government grants	**(15,000)**	(699)
Interest-bearing bank and other borrowings	**(1,089,952)**	(116,500)
Tax payable	**(15,728)**	(8,381)
Minority interests	**(651,212)**	–
Fair value/carrying value of net assets at dates of acquisition/consolidation	**509,364**	276,663
Excess of acquirer's interest in the net fair value of acquiree's identifiable assets, liabilities and contingent liabilities over cost	**–**	(170,817)
	509,364	105,846
Satisfied or represented by:		
Other receivables	**–**	100,546
Interests in associates	**509,364**	–
Available-for-sale financial assets	**–**	5,300
	509,364	105,846

37. BUSINESS COMBINATIONS *(continued)*

(a) Acquisition/consolidation of subsidiaries *(continued)*

An analysis of the net inflow of cash and cash equivalents in respect of the acquisition/consolidation of subsidiaries is as follows:

	2005	2004
	RMB'000	*RMB'000*
Cash and bank balances acquired and net inflow of cash and cash equivalents in respect of the acquisition/consolidation of subsidiaries in the consolidated balance sheet	**450,875**	38,788
Less: Non-pledged time deposits with original maturity of three months or more when acquired	**(210,000)**	–
Net inflow of cash and cash equivalents in respect of the acquisition/consolidation of subsidiaries in the consolidated cash flow statements	**240,875**	38,788

Notes:

(i) As detailed in note 5(ii) to the consolidated financial statements, the Group obtained control over Zhuye Torch and Zhuzhou Diamond in May 2005 and hence Zhuye Torch and Zhuzhou Diamond were consolidated into the consolidated financial statements starting from 1 June 2005.

Had the aforesaid control been obtained at the beginning of 2005, the revenue of the Group would have been RMB10,915,474,000 and there is no change in the Group's profit attributable to the equity holders of the parent for the year ended 31 December 2005.

(ii) As detailed in note 5(i) to the consolidated financial statements, Zhuying acquired a 98% equity interest in Diamond Refractory from Zhongkexin and the consideration was settled by offsetting against the amount receivable from Zhongkexin of RMB100,546,000. In May 2004, Zhuying also acquired the remaining 2% equity interest in Diamond Refractory from ZCC Import and Export Company Limited ("ZCC Import and Export"), a subsidiary of Zhuying, at a consideration of RMB5,300,000. The consideration was settled through the current account with ZCC Import and Export.

Since the date of acquisition, Diamond Refractory had contributed a profit of RMB944,000 to the Group's profit attributable to the equity holders of the parent for the year ended 31 December 2004.

Had the aforesaid acquisition by Zhuying taken place at the beginning of 2004, the Group's net profit attributable to the equity holders of the parent would have been RMB543,386,000 for the year ended 31 December 2004 and the revenue of the Group would have been RMB7,484,896,000 for that year.

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37. BUSINESS COMBINATIONS *(continued)*

(b) Deconsolidation of a subsidiary

As mentioned in note (a) above, Zhuye Torch has been accounted for as an associate since 1 September 2004 as the Group's effective interest in Zhuye Torch was reduced from 60.18% to 43.28% after the issue of 120,000,000 domestic shares by Zhuye Torch to the public in August 2004. Thus, Zhuye Torch has been deconsolidated from the Group since 1 September 2004.

The carrying value of the identifiable assets and liabilities of Zhuye Torch deconsolidated by the Group at the date of deconsolidation is as follows:

	2004 *RMB'000*
Property, plant and equipment	617,378
Intangible assets	81
Available-for-sale financial assets	1,061
Deferred tax assets	10,529
Inventories	507,532
Trade receivables	50,020
Bills receivable	40,707
Prepayments, deposits and other receivables	227,188
Other financial assets	2,000
Cash and cash equivalents	111,883
Trade payables	(123,212)
Bills payable	(10,000)
Other payables and accruals	(150,610)
Interest-bearing bank and other borrowings	(834,002)
Tax payable	(13,759)
Government grants	(5,000)
Minority interests	(168,326)
Carrying value of net assets at the date of deconsolidation	263,470
Gain on dilution of interest in Zhuye Torch	121,275
	384,745
Satisfied by:	
Interests in associates	384,745

37. BUSINESS COMBINATIONS *(continued)*

(b) Deconsolidation of a subsidiary *(continued)*

The net outflow of cash and cash equivalents in respect of the deconsolidation of Zhuye Torch is RMB111,883,000:

38. NOTES TO THE CONSOLIDATED CASH FLOW STATEMENT

In addition to the transactions mentioned in the business combinations in note 37 to the consolidated financial statements, the Group had the following major non-cash transactions during the year ended 31 December 2004.

(a) During the year ended 31 December 2004, the HNG Group contributed property, plant and equipment amounting to RMB12,987,000 and lease prepayments amounting to RMB80,230,000 to the Group.

(b) In 2004, the Group disposed of Zhuzhou Zuanshi Gongchen Co. Ltd., an associate of the Group, for a consideration of RMB10,001,000. Part of the consideration amounting to RMB6,511,000 was settled in cash and the remaining balance of RMB3,490,000 was satisfied by the transfer of lease prepayments.

(c) During the year ended 31 December 2004, the Group transferred lease prepayments with a carrying value of RMB10,920,000 to Zhuzhou Diamond for a consideration of RMB10,920,000. The consideration was settled through the current account.

(d) Pursuant to an approval document from relevant government authorities, Zhuye reduced its capital by RMB106,351,000 and the proceeds from the reduction of capital will be paid back to the HNG Group. Out of the proceeds of RMB106,351,000, RMB45,665,000 was settled through the transfer of property, plant and equipment to the HNG Group at 31 December 2004 and the remaining balance of RMB60,686,000 was settled in February 2006.

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38. NOTES TO THE CONSOLIDATED CASH FLOW STATEMENT *(continued)*

(e) At 31 December 2004, the Group distributed net assets with a carrying value of RMB452,374,000 to the HNG Group pursuant to the Reorganisation as follows:

	2004
	RMB'000
Property, plant and equipment	234,860
Lease prepayments	61,159
Available-for-sale financial assets	93,153
Trade receivables	47,147
Prepayments, deposits and other receivables	114,377
Other financial assets	29,158
Cash and cash equivalents	37,223
Trade payables	(4,294)
Other payables and accruals	(67,970)
Minority interests	(92,439)
	452,374

The above net asset distribution included the assets and liabilities of the discontinued businesses and entities as mentioned in note 12 to the consolidated financial statements and other individual assets and liabilities historically owned by the Relevant Businesses but bear little relevance to the Group's future business activities.

(f) During the year ended 31 December 2005, the Group increased its investment in Zhuzhou Diamond, an associate of the Group. Thereafter, as detailed in note 5(ii) to the consolidated financial statements, the Group obtained control over Zhuzhou Diamond in May 2005 and Zhuzhou Diamond was consolidated as a subsidiary in the consolidated financial statements starting from 1 June 2005.

39. CONTINGENT LIABILITIES

At the balance sheet date, contingent liabilities not provided for in the consolidated financial statements were as follows:

	The Group	
	2005	2004
	RMB'000	*RMB'000*
Guarantees given to banks in respect of bank loans granted to:		
A fellow subsidiary	**–**	206,400
An associate	**30,000**	392,154
A third party	**–**	1,000
	30,000	599,554

40. OPERATING LEASE ARRANGEMENTS

As a lessee, the Group leases certain property, plant and equipment under operating lease arrangements, with leases negotiated for terms of one to twenty years..

At 31 December 2005, the Group had total future minimum lease payments under non-cancellable operating leases falling due as follows:

	The Group	
	2005	2004
	RMB'000	*RMB'000*
Within one year	**15,640**	54
In the second to fifth years, inclusive	**62,499**	–
After five years	**224,533**	–
	302,672	54

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41. COMMITMENTS

In addition to the operating lease commitments detailed in note 40 to the consolidated financial statements, the Group had the following capital commitments at the balance sheet date:

	The Group	
	2005	2004
	RMB'000	*RMB'000*
Contracted, but not provided for:		
– Acquisition of property, plant and equipment	**172,909**	272,795
Authorised, but not contracted for:		
– Acquisition of property, plant and equipment	**14,184**	83,141

42. RELATED PARTY TRANSACTIONS

In addition to the transactions detailed elsewhere in these consolidated financial statements, the Group had the following material transactions with the related parties.

(a) Transactions with companies controlled by the ultimate holding company of the Company

Name of related parties	Nature of transactions	2005	2004
		RMB'000	*RMB'000*
Huangshaping Mine Chenzhou Industrial and Trading Company	Purchases of raw materials	**451**	923
Hunan Huangshaping Lead and Zinc Mine Changfu Industrial Company	Purchases of raw materials	**24,778**	15,793
	Purchases of consumables	**–**	540
	Provision of transportation services	**3,691**	3,722
	Repairs and maintenance	**4,220**	5,446
	Provision of electricity	**1,020**	1,136
	Subcontracting fee income	**1,149**	1,089
	Sales of raw materials	**814**	–
Shizhuyuan Nonferrous Metal Pasturage	Purchases of raw materials	**8,412**	–
	Sales of raw materials	**1,882**	–
Shizhuyuan Nonferrous Metal Integrated Services Company	Purchases of consumables	**1,373**	–

42. RELATED PARTY TRANSACTIONS *(continued)*

(a) Transactions with companies controlled by the ultimate holding company of the Company *(continued)*

Name of related parties	Nature of transactions	**2005** *RMB'000*	2004 *RMB'000*
Chenzhou Shizhuyuan Yingshi Co. Ltd.	Provision of electricity	**1,047**	–
	Purchases of raw materials	**307**	–
Hunan Shizhuyuan Nonferrous Metal Mine Transportation Company	Provision of transportation services	**7,849**	–
	Sales of raw materials	**900**	–
Hunan Shizhuyuan Nonferrous Metal Mine Machinery Company	Subcontracting fees	**2,728**	–
	Installation charges	**1,791**	–
Chenzhou Shizhuyuan Construction Company	Provision of construction services	**3,943**	–
Shizhuyuan Industrial Company	Repairs and maintenance	**1,500**	–
Lengshuijiang Hsikwangshan Transportation Company	Provision of transportation services	**9,344**	–
	Repairs and maintenance	**250**	–
Lengshuijiang Hsikwangshan Property Management Company	Repairs and maintenance	**500**	–
	Provision for electricity	**500**	–
	Provision of property management services	**3,400**	–
Lengshuijiang Hsikwangshan Machinery Manufacturing Company	Subcontracting fees	**9,660**	–
	Sales of raw materials	**733**	–
Lengshuijiang Hsikwangshan Industrial Company	Provision of electricity	**1,170**	–
Hunan Xianglv Company Limited	Sales of products	**11,315**	4,123
	Purchases of raw materials	**2,744**	4,993
Hainan Haizhou Industrial Co. Ltd.	Sales of products	**9,005**	–
Yao Gang Xian Tungsten Mine	Purchases of raw materials	**106,050**	–

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42. RELATED PARTY TRANSACTIONS *(continued)*

(a) Transactions with companies controlled by the ultimate holding company of the Company *(continued)*

Name of related parties	Nature of transactions	2005 RMB'000	2004 RMB'000
Chenzhou Changsheng Co. Ltd.	Purchases of raw materials	**1,080**	–
	Provision of storage	**–**	920
Zhuzhou Tongda Hardest Materials Company	Sales of products	**584**	–
Beijing XinQuan Technology Trading Company	Purchases of raw materials	**7,566**	–
Zhuying Assets Operation Company	Purchases of raw materials	**1,588**	–
	Provision of security services	**1,495**	–

(b) Transactions with associates

Name of related parties	Nature of transactions	2005 RMB'000	2004 RMB'000
Zhuzhou Changjiang	Sales of products	**22,130**	6,495
	Purchases of raw materials	**41,185**	18,049
	Sales of property, plant and equipment	**3,230**	–
	Provision of electricity	**16,596**	15,400
Zhuzhou Diamond	Sales of products	**155,827**	59,273
	Purchases of raw materials	**11,169**	16,644
	Rental income	**–**	3,230
	Sales of land use right	**–**	10,920
Zhuzhou Diamond Construction Company Limited	Provision of construction services	**–**	22,707
Zhuye Torch	Sales of products	**68,274**	14,262
	Purchases of raw materials	**87,245**	108,583
	Provision of electricity	**34,732**	25,520

42. RELATED PARTY TRANSACTIONS *(continued)*

(b) Transactions with associates *(continued)*

Name of related parties	Nature of transactions	2005 RMB'000	2004 RMB'000
Xizang Zhuye Mining Limited Liability Company	Purchases of raw materials	**4,571**	11,239
Zhuzhou Huaxin Cemented Carbides Tool Factory	Sales of products	**–**	3,993

These transactions were conducted in accordance with prices and terms mutually agreed between the parties.

(c) Guarantee granted by the ultimate holding company of the Group

Name of the related party	Nature of the guarantee	2005 RMB'000	2004 RMB'000
HNG	Corporate guarantee	**328,000**	100,000

The above corporate guarantee granted by the ultimate holding company was released by the lending bank subsequent to 31 December 2005.

(d) Guarantee granted by a fellow subsidiary for securing the Group's bank loans

Name of the related party	Nature of the guarantee	2005 RMB'000	2004 RMB'000
Hunan Shuikoushan Nonferrous Metal Group Co., Ltd.	Corporate guarantee	**–**	276,370

(e) Guarantees granted for securing associates' bank loans

Name of associates	Nature of guarantees	2005 RMB'000	2004 RMB'000
Zhuzhou Diamond	Corporate guarantee	**–**	49,000
Zhuye Torch	Corporate guarantee	**–**	313,154
Zhuzhou Changjiang	Corporate guarantee	**30,000**	30,000

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42. RELATED PARTY TRANSACTIONS *(continued)*

(f) Guarantees granted for securing the bank loans of a subsidiary of HNG

Name of the related party	Nature of the guarantee	2005 RMB'000	2004 RMB'000
Hunan Shuikoushan Nonferrous Metal Group Co., Ltd.	Corporate guarantee	–	206,400

(g) Lease of land use right from the ultimate holding company:

Name of the related party	Nature of the transaction	2005 RMB'000	2004 RMB'000
HNG	Lease of land use right	5,042	–

43. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES

The financial assets of the Group mainly include cash and cash equivalents, pledged deposits, other financial assets, trade and bills receivables, and other receivables. The financial liabilities of the Group mainly include other payables and accruals, trade and bills payables, bank loans and other borrowings. The Group did not enter into any derivative activities during the years ended 31 December 2004 and 2005.

The carrying amounts of the financial assets and liabilities of the Group approximated to their fair values as at each of the balance sheet dates. Fair value estimates are made at a specific point in time and are based on relevant market information and information about the financial instruments. These estimates are subjective in nature and involve uncertainties and matters of significant judgement and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

The main risks arising from the Group's financial instruments are credit risk, liquidity risk, interest rate risk and foreign currency risk. The directors review and agree policies for managing each of these risks and they are summarised below.

43. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES *(continued)*

Credit risk

Substantial amounts of the Group's cash and cash equivalents are held in major financial institutions located in the PRC, which management believes are of high credit quality.

The Group has no significant credit risk with major customers since the Group maintains long term and stable business relationships with these major customers. The Group performs ongoing credit evaluations of its customers' financial conditions and generally does not require collateral on accounts receivable. The Group maintains an allowance of doubtful accounts and actual losses have been within management's expectations.

The Group's bills receivable are guaranteed by banks and the risk of default in payment is minimal.

The Group's trade and bills receivables, and other receivables represent the Group's maximum exposure to credit risk attributable to its financial assets.

Other than the aforesaid, the Group has no significant concentration of credit risk with any single counterparty.

Liquidity risk

The Group policy is to maintain sufficient cash and cash equivalents or have available funding through an adequate amount of committed credit facilities from banks to meet its commitments over the foreseeable future in accordance with its strategic plan.

Interest rate risk

The Group's exposure to the risk of changes in market interest rates relates primarily to the Group's debt obligations with floating interest rates.

Foreign currency risk

Except for export sales which are mainly transactions in United States dollars, the Group's revenue is transacted in RMB which is not freely convertible into foreign currencies. Fluctuation of exchange rates of RMB against foreign currencies can affect the Group's results of operations.

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44. EVENTS AFTER THE BALANCE SHEET DATE

(a) In March 2006, the Group entered into various agreements with the HNG Group for the purchase of goods and services therefrom, further details of which are set out in the section headed "Connected Transactions" contained in the Company's prospectus dated 21 March 2006.

(b) In March 2006, the Company declared a special dividend of RMB230,980,000 to HNG. Further details of which are set out in note 13 to the consolidated financial statements.

(c) In March 2006, the Company issued 1,075,582,000 new H shares to the public at a price of HK$1.65 per share (equivalent to approximately RMB1.70 per share) and such H shares were listed on the Main Board of The Stock Exchange of Hong Kong Limited. In addition, 107,558,000 H shares converted from certain domestic shares held by HNG, Shenzhen Bangxin and Hunan Valin were transferred to the National Council for the Social Security Fund.

(d) In April 2006, as a result of the over-allotment option as detailed in the Company's prospectus dated 21 March 2006, the Company issued 161,336,000 new H shares to the public at HK$1.65 per share (equivalent to approximately RMB1.70 per share) and such H shares were listed on the Main Board of The Stock Exchange of Hong Kong Limited. In addition 16,134,000 H shares converted from certain domestic shares held by HNG, Shenzhen Bangxin and Hunan Valin were transferred to the National Council for the Social Security Fund.

45. APPROVAL OF THE FINANCIAL STATEMENTS

The financial statements were approved and authorised for issue by the board of directors on 25 April 2006.