You should read the following discussion in conjunction with our and Tianye Chemical's consolidated financial statements, and selected historical consolidated financial data, in each case, together with the accompanying notes thereto included elsewhere in this Prospectus.

SELECTED HISTORICAL FINANCIAL INFORMATION

The tables below present selected historical financial information about our Company and Tianye Chemical for the periods indicated.

The selected audited consolidated income statement data for the years ended 31 December 2003, 2004 and 2005 and the three months ended 31 March 2006, and the unaudited consolidated income statement data for the three months ended 31 March 2005, as well as the selected audited consolidated balance sheet data of our Company as of 31 December 2003, 2004 and 2005 and 31 March 2006 have been derived from the Accountants' Report of our Company included in Appendix IA to this Prospectus.

The selected audited consolidated income statement data for the years ended 31 December 2003, 2004 and 2005, as well as the selected audited consolidated balance sheet data of Tianye Chemical as of 31 December 2003, 2004 and 2005 have been derived from the Accountants' Report on Tianye Chemical included in Appendix IB to this Prospectus. For the basis of presentation of our and Tianye Chemical's financial information, see "—Management's discussion and analysis of financial condition and results of operations—Basis of presentation".

We did not consolidate the operating results of Tianye Chemical until 19 January 2006 when we obtained control of Tianye Chemical. The operating results of Tianye Chemical for the three months ended 31 March 2006 have been consolidated with those of our Company from 19 January 2006 and relevant disclosure has been included in note (e) section 8 of the Accountants' Report in Appendix IA to this Prospectus. The results of Tianye Chemical for the three months ended 31 March 2006 are therefore not presented separately. As a result, our consolidated income statement data and other financial data for the three months ended 31 March 2005 are not comparable to our consolidated income statement data and other financial data for the three months ended 31 March 2006 and the balance sheet data as of 31 March 2006.

The selected historical audited consolidated financial information has been prepared in accordance with IFRS.

Our Company

The following table sets forth our selected consolidated income statement data for the years ended 31 December 2003, 2004 and 2005 and the three months ended 31 March 2005 and 2006:

	Year ended 31 December			Three months ended 31 March	
	2003	2004	2005	2005	2006
Summary consolidated income statement data of our Company	RMB	RMB	RMB	RMB	RMB
	(in millions, except for per share information)				
	(audited)			(unaudited)	(audited)
Revenue	738.2	2,027.3	2,371.0	505.6	697.7
Cost of sales	(476.5)	(1,095.0)	(1,293.1)	(296.0)	(449.1)
Gross profit	261.7	932.3	1,077.9	209.6	248.6
Other income and gains	79.4	40.7	1.7	0.9	7.1
Excess over the cost of a business combination	—	—	—	—	577.6
Selling and distribution costs	(19.0)	(31.1)	(15.4)	(1.9)	(3.6)
Administrative expenses	(56.5)	(76.6)	(130.7)	(17.4)	(42.3)
Other expenses	(23.8)	(28.8)	(103.1)	(37.0)	(0.8)
Finance revenue	3.8	11.8	24.4	3.6	7.0
Finance costs	(7.7)	(15.0)	(15.5)	(4.1)	(10.7)
Exchange gain/(loss), net	(56.1)	(40.0)	189.5	41.9	(6.2)
Share of profits of associates	0.9	1.6	1.9	0.4	0.5
Profit before tax	182.7	794.9	1,030.7	196.0	777.2
Income tax expense	(17.2)	(26.9)	(47.5)	(3.2)	(17.7)
Profit for the year/period	165.5	768.0	983.2	192.8	759.5
Profit for the year/period attributable to equity holders of the parent	137.2	720.5	943.8	189.6	746.9
Basic earnings per share attributable to ordinary equity holders of the parent (cents)	4.57	24.02	31.46	6.32	24.90

The following table sets forth our selected consolidated balance sheet data as of 31 December 2003, 2004 and 2005 and 31 March 2006:

	As of 31 December			As of 31 March
	2003	2004	2005	2006
Summary consolidated balance sheet data of our Company	RMB	RMB	RMB	RMB
	(in millions) (audited)			
ASSETS				
Non-current assets	3,075.1	3,109.3	3,617.5	6,494.8
Current assets	1,058.5	1,734.7	2,535.5	2,218.2
Total assets	4,133.6	4,844.0	6,153.0	8,713.0
EQUITY AND LIABILITIES				
Total equity	2,148.6	2,884.3	4,077.6	3,759.5
Non-current liabilities	1,422.9	1,312.7	1,052.8	655.0
Current liabilities	562.1	647.0	1,022.6	4,298.5
Total equity and liabilities	4,133.6	4,844.0	6,153.0	8,713.0

The following table sets forth other selected consolidated financial information of our Company for the years ended 31 December 2003, 2004 and 2005 and the three months ended 31 March 2005 and 2006:

	Year ended 31 December			Three months ended 31 March	
	2003	2004	2005	2005	2006
Other selected consolidated financial information of our Company	RMB	RMB	RMB	RMB	RMB
	(in millions, except for percentages)				
Capital expenditures	1,294.5	292.3	461.8	20.1	340.4
Net cash inflow from operating activities	185.4	1,074.6	917.1	215.8	535.0
Net cash outflow from investing activities	(987.9)	(626.2)	(361.4)	(510.5)	(1,316.5)
Net cash inflow/(outflow) from financing activities	627.5	(27.1)	52.2	15.8	419.6
Gross profit margin	35.5%	46.0%	45.5%	41.5%	35.6%
Net profit margin	18.6%	35.5%	39.8%	37.5%	107.1%
EBITDA	320.2	1,060.9	1,166.5	251.4	312.7
EBITDA margin	43.4%	52.3%	49.2%	49.7%	44.8%

The table below sets forth a full quantitative reconciliation of EBITDA of our Company with profit for the year/period. EBITDA, provided in the tables above and below, is not a standard measure under IFRS, but is a widely used financial indicator of a company's ability to service and incur debt. As our business is capital intensive, capital expenditure requirements, levels of debt, interest expenses and gains and losses from foreign exchange may have a significant impact on the profit for the year/period of companies with similar operating results.

EBITDA should not be considered in isolation or construed as an alternative to cash flows, net profit or any other measure of performance or as an indicator of our operating performance, liquidity, profitability or cash flows generated by operating, investing or financing activities. EBITDA does not account for interest income, income tax expense, interest expense, the excess over the cost of a business combination for the three months ended 31 March 2006 or other non-operating cash expenses such as depreciation, amortization, gains and losses from foreign exchange and change in fair value of derivative financial instruments. In evaluating EBITDA, we believe that investors should consider, among other things, turnover and operating expenses and the amount by which EBITDA exceeds capital expenditures and other charges.

We have included EBITDA because net profit includes many accounting items associated with capital expenditures, such as depreciation, as well as non-operating items, such as income tax expense interest income and expense and exchange differences and the excess over the cost of a business combination. By minimizing differences in capital expenditures and the associated depreciation expenses as well as reported tax positions, interest income and expenses, the foreign exchange gains or losses and the excess over the cost of a business combination, we believe EBITDA provides further information about our operating performance and is a useful supplement to cash flow data as a measure of our performance and our ability to generate cash flow from operations to cover debt services and internally funded capital expenditures. Funds depicted by this measure may not be available for debt services due to covenant restrictions, capital expenditure requirements and other commitments. EBITDA presented in this Prospectus may not be comparable to similarly titled measures presented by other companies. You should not compare our EBITDA to EBITDA presented by other companies because not all companies use the same definitions.

	Year ended 31 December			Three months ended 31 March	
	2003	2004	2005	2005	2006
	RMB	RMB	RMB (in millions)	RMB	RMB
Profit for the year/period	165.5	768.0	983.2	192.8	759.5
Interest income	(3.8)	(11.8)	(24.4)	(3.6)	(7.0)
Finance costs	7.7	15.0	15.5	4.1	10.7
Foreign exchange differences, net	56.1	40.0	(189.5)	(41.9)	6.2
Income tax expense	17.2	26.9	47.5	3.2	17.7
Depreciation	123.2	257.9	264.4	66.0	107.1
Amortization	1.5	2.2	1.9	0.5	1.9
Excess over the cost of a business combination	—	—	—	—	(577.6)
Change in fair value of derivative financial instruments	(47.2)	(37.3)	67.9	30.3	(5.8)
EBITDA	320.2	1,060.9	1,166.5	251.4	312.7

Tianye Chemical

We took effective control of Tianye Chemical for accounting purposes on 19 January 2006. We therefore did not consolidate Tianye Chemical's operating results and financial performance until 19 January 2006. As such, the operating results and financial performance of Tianye Chemical were not consolidated into ours as of and for the years ended 31 December 2003, 2004 and 2005 and the three months ended 31 March 2005. The operating results of Tianye Chemical for the three months ended 31 March 2006 have been consolidated with those of our Company from 19 January 2006 and relevant disclosure has been included in note (e) of Section 8 of the Accountants' Report in Appendix IA to this Prospectus. The results of Tianye Chemical for the three months ended 31 March 2006 are therefore not presented separately.

The following tables set forth selected consolidated financial information of Tianye Chemical for the three years ended 31 December 2005.

The following table sets forth the selected consolidated income statement data of Tianye Chemical for the years ended 31 December 2003, 2004 and 2005:

	Year ended 31 December		
	2003	2004	2005
Summary consolidated income statement data of Tianye Chemical	RMB	RMB (in millions) (audited)	RMB
Revenue	595.1	844.4	745.4
Cost of sales	(630.9)	(748.6)	(681.6)
Gross profit/(loss)	(35.8)	95.8	63.8
Other income and gains	2.5	19.8	19.5
Selling and distribution costs	(2.1)	(4.9)	(5.1)
Administrative expenses	(58.1)	(61.8)	(66.5)
Other expenses	(41.1)	(64.0)	(16.6)
Finance revenue	3.5	3.0	6.0
Finance costs	(60.9)	(69.2)	(64.7)
Exchange gain/(loss), net	(193.4)	(47.8)	236.6
Profit/(loss) before tax	(385.4)	(129.1)	173.0
Income tax credit/(expense)	18.1	(31.8)	—
Profit/(loss) for the year	(367.3)	(160.9)	173.0

The following table sets forth the selected consolidated balance sheet data of Tianye Chemical as of 31 December 2003, 2004 and 2005:

Summary consolidated balance sheet data of Tianye Chemical	As of 31 December		
	2003	2004	2005
	RMB	RMB (in millions) (audited)	RMB
ASSETS			
Non-current assets	2,118.7	2,051.7	2,441.0
Current assets	642.3	665.1	299.8
Total assets	2,761.0	2,716.8	2,740.8
EQUITY AND LIABILITIES			
Total equity	558.4	397.3	570.3
Non-current liabilities	1,576.8	1,546.5	1,287.6
Current liabilities	625.8	773.0	882.9
Total equity and liabilities	2,761.0	2,716.8	2,740.8

The following table sets forth other selected consolidated financial information of Tianye Chemical for the years ended 31 December 2003, 2004 and 2005:

Other selected consolidated financial information of Tianye Chemical	Year ended 31 December		
	2003	2004	2005
	RMB	RMB (in millions, except for percentages)	RMB
Capital expenditures	14.0	204.9	586.4
Net cash inflow from operating activities	53.1	447.4	262.3
Net cash outflow from investing activities	(10.5)	(644.6)	(258.7)
Net cash outflow from financing activities	(2.6)	(2.3)	(53.0)
Gross profit margin	—(1)	11.3%	8.6%
Net profit margin	—(2)	—(3)	23.2%
EBITDA(4)	75.9	170.0	179.7
EBITDA margin(4)	12.8%	20.1%	24.1%

(1) Tianye Chemical recorded a gross loss of RMB35.8 million for 2003.

(2) Tianye Chemical recorded a net loss of RMB367.4 million for 2003.

(3) Tianye Chemical recorded a net loss of RMB161.1 million for 2004.

(4) EBITDA is not a standard measure under IFRS. EBITDA should not be considered in isolation or construed as an alternative to cash flows, net profit or any other measure of performance or as an indicator of our operating performance, liquidity, profitability or cash flows generated by operating, investing or financing activities. EBITDA does not account for interest income, income tax expense, interest expense or other non-operating cash expenses such as depreciation, amortization and gains and losses from foreign exchange. In evaluating EBITDA, we believe that investors should consider, among other things, turnover and operating expenses and the amount by which EBITDA exceeds capital expenditures and other charges.

The following table sets forth a full quantitative reconciliation of EBITDA of Tianye Chemical with its profit/(loss) for the year. EBITDA should not be considered in isolation or construed as an alternative to cash flows, net profit or any other measure of performance or as an indicator of Tianye Chemical's operating performance, liquidity, profitability or cash flows generated by operating, investing or financing activities. EBITDA does not account for interest income, income tax expense, interest expense, and other non-operating cash expenses such as depreciation, amortization and gains and losses from foreign exchange. In evaluating EBITDA, we believe that investors should consider, among other things, turnover and operating expenses and the amount by which EBITDA exceeds capital expenditures and other charges. For other rationales for the inclusion of EBITDA, see "—Selected historical financial information—Our Company".

	Year ended 31 December		
	2003	2004	2005
	RMB	RMB (in millions)	RMB
Profit/(loss) for the year	(367.3)	(160.9)	173.0
Interest income	(3.5)	(3.0)	(6.0)
Finance costs	60.9	69.2	64.7
Foreign exchange differences, net	193.4	47.8	(236.6)
Income tax (credit)/expense	(18.1)	31.8	—
Depreciation	208.4	183.0	182.5
Amortization	2.1	2.1	2.1
EBITDA	75.9	170.0	179.7

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

You should read the following discussion and analysis in conjunction with the consolidated financial information included in the Accountants' Report of our Company and the notes thereto included in Appendix IA to this Prospectus and the selected historical financial information and operating data included elsewhere in this Prospectus. The financial information has been prepared in accordance with IFRS. We implemented a restructuring in preparation for the initial listing of our H Shares on the Hong Kong Stock Exchange, the details of which are set forth in Section 1 of the Accountants' Report of our Company included in Appendix IA to this Prospectus.

We took effective control of Tianye Chemical on 19 January 2006 and the operating and financial results of Tianye Chemical were consolidated into ours from 19 January 2006 when our financial information as of and for the three months ended 31 March 2006 were prepared. The consolidated financial information of Tianye Chemical and the notes to the financial information, prepared in accordance with IFRS, are included in the Accountants' Report on Tianye Chemical in Appendix IB to this Prospectus.

Overview

We are one of the largest and most efficient nitrogenous fertilizer producers in terms of production volume and energy consumption, respectively, in China, which is the largest mineral fertilizer consuming country in the world. The core of our operations is the production and sale of urea, the most commonly used nitrogenous fertilizer in China. As one of the major subsidiaries of CNOOC, the third largest petroleum company in China, and a sister company of CNOOC Limited, one of the world's largest oil and gas exploration and production companies in terms of reserves, we are well-positioned to further enhance our fertilizer operations through organic expansion. We also seek to benefit from potential industry consolidation in China, which we expect will provide us with the opportunity to accelerate our production capacity and market expansion through selective acquisitions. In line with such strategy, we acquired Tianye Chemical, a large-scale producer of urea and methanol based in Huhhot, Inner Mongolia.

By means of the Acquisition, we have been able to significantly increase our designed production capacity, broaden our customer base and immediately capture new markets in northern and northeastern China at a cost substantially below that which we would have incurred had we chosen to construct a new production facility. This expansion of coverage from the south to the north will reinforce our position as one of China's largest nitrogenous fertilizer producers. As of the Latest Practicable Date, we owned in aggregate three integrated ammonia and urea production facilities with a total designed annual production capacity of 1,840,000 tonnes of urea.

As a result of the Acquisition, we also own a methanol plant that enables us to produce 200,000 tonnes of methanol per annum. We have constructed a second methanol plant with a designed annual production capacity of 600,000 tonnes of methanol in Hainan through CNOOC Jiantao, which commenced trial production in September 2006. Upon commencement of mass production at CNOOC Jiantao, expected in January 2007 our total annual designed methanol production capacity will be increased to 800,000 tonnes per annum. Once CNOOC Jiantao commences mass production, it is intended that no less than 400,000 tonnes per annum will be supplied to Hong Kong Kingboard for its own usage or consumption, our joint-venture partner and a 40% shareholder of CNOOC Jiantao. See "Connected Transactions".

Basis of Presentation

This Prospectus contains the consolidated financial information of our Company and our consolidated subsidiaries, as of and for the years ended 31 December 2003, 2004 and 2005 and for the three months ended 31 March 2005 and 2006. The operating results of Tianye Chemical for the years ended 31 December 2003, 2004, 2005 and the three months ended 31 March 2005 were not consolidated with our results on a historical basis as we did not gain effective control of Tianye Chemical until 19 January 2006. We consolidated the operating results of Tianye Chemical from the date on which control was transferred to us, i.e. 19 January 2006. Accordingly, our operating results for the three months ended 31 March 2006 are not comparable with that of the three months ended 31 March 2005.

Our Company

Our consolidated financial information as of and for the years ended 31 December 2003, 2004 and 2005 and as of and for the three months ended 31 March 2005 and 2006 presents the financial information of our Company and all of our subsidiaries on a consolidated basis, after eliminating all significant inter-company balances and transactions. Our consolidated subsidiaries as of and for the years ended 31 December 2003, 2004 and 2005 and as of and for the three months ended 31 March 2005 and 2006 are set out in Section 4 to Appendix IA to this Prospectus.

Our subsidiaries are consolidated from the date on which control is transferred to our Company and cease to be consolidated from the date on which control is transferred out of our Company. As a result, we consolidated the financial information of Tianye Chemical from 19 January 2006 onwards.

Our interest in CNOOC Jiantao is accounted for by proportionate consolidation which includes recognizing in the financial information a proportionate share of its assets, liabilities, income and expenses with similar items on a line-by-line basis because CNOOC Jiantao is a jointly-controlled entity.

In addition, on 25 April 2005, we established a joint venture, Hainan Basuo, with Hainan Provincial Government to operate Port of Basuo, the second largest deepwater seaport in Hainan in terms of freight throughput. We owned a 72.5% equity interest in Hainan Basuo as of 31 December 2005 and the Latest Practicable Date. Our initial investment in Hainan Basuo is RMB304.2 million. In preparing our consolidated financial information for the year ended 31 December 2005, we have included the results of Hainan Basuo since its establishment.

Tianye Chemical

The consolidated financial information of Tianye Chemical presents the financial information of Tianye Chemical and all of its subsidiaries on a consolidated basis as of and for the years ended 31 December 2003, 2004 and 2005 and as of 19 January 2006 and for the 19-day periods ended 19 January 2005 and 2006, after eliminating all significant inter-company balances and transactions. The consolidated subsidiaries of Tianye Chemical as of and for the years ended 31 December 2003, 2004 and 2005 and as of 19 January 2005 and 2006 are set out in Section 4 to Appendix IB to this Prospectus. The operating results from 19 January 2006 to 31 March 2006 and balance sheet data as of 31 March 2006 were consolidated with those of our Company.

Factors Affecting Our Results of Operations and Financial Condition

The factors principally affecting and which will continue to affect the operations of our Company and of Tianye Chemical, or the main drivers of consolidated operating results of our Company and of Tianye Chemical, have been and/or are expected to be the following:

Business Environment

Our performance is directly affected by the supply of, and the international and domestic market demand for, nitrogenous fertilizer products.

We believe that the domestic fertilizer industry in the PRC has growth potential and that market demand for our urea products will continue to grow due to a number of factors, including (i) economic growth in China evidenced by the fact that, in 2005, GDP grew 9.9% according to the Statistics Report on National Economy and Social Development of the PRC in 2005 published by the National Bureau of Statistics of China, and is expected to grow 9.2% in 2006 according to the forecast of the World Bank; (ii) growing demand for agricultural products to satisfy the needs of a large and growing population in China; (iii) the limited total area of arable land in China and the ensuing importance of fertilizers to increase crop yields; (iv) the growth of consumer demand for cash crops such as vegetables and fruits, which generally require the application of higher volumes of fertilizers than traditional farm crops, and for forestry products; and (v) the PRC Government's policy of encouraging the development of the agricultural industry by way of preferential tax treatments.

Before 2004, the PRC Government fully or partially refunded the VAT otherwise payable by the sellers of fertilizer products to encourage domestic mineral fertilizer producers, including us, to export their fertilizer products. The PRC Government began to impose seasonal export tariffs applicable to the export sales of mineral fertilizers in 2005, which in turn impacted our export sales. The PRC Government also gradually introduced various measures to discourage export sales of mineral fertilizers by reducing the export VAT refund which we previously enjoyed. As a result of the VAT exemption and refund mechanisms implemented by the PRC Government for domestic sales and the changes in VAT and tariff policies in respect of exports of fertilizer products, we changed the mix of our domestic sales and export sales in 2005. Revenues derived from our export sales accounted for approximately 41.1%, 40.4% and 15.5% of our revenue from sales of fertilizers for the years ended 31 December 2003, 2004 and 2005, respectively. We made no export sales in the three months ended 31 March 2005 and in the three months ended 31 March 2006.

Facilities Utilization and Sales Volume

Increases or decreases in facilities utilization rates can have a significant effect on production volume, unit costs and gross profit margins. As of the Latest Practicable Date, we operated a total of three integrated ammonia and urea production facilities, with an aggregate designed urea production capacity of approximately 6,225 tonnes per day, or 1,840,000 tonnes per annum. According to the industry norm in China for the urea industry, the designed annual production capacity is calculated on the assumption that facilities are in operation for 300 days per year.

The following table sets forth information on the utilization rates and urea production volumes of our facilities during the Track Record Period and the six months ended 30 June 2006:

	2003		2004		2005		Three months ended 31 March 2006		Six months ended 30 June 2006	
	Production volume	Utilization(1)	Production volume	Utilization(1)	Production volume	Utilization(1)	Production volume	Utilization(3)	Production volume	Utilization(1)
	(Tonnes)	(%)	(Tonnes)	(%)	(Tonnes)	(%)	(Tonnes)	(%)	(Tonnes)	(%)
Fudao Phase I	602,373	115.8	618,888	119.0	535,881	103.1	122,091	93.9	284,800	109.5
Fudao Phase II	—(2)	—	794,051	99.3	825,132	103.1	151,603	75.8	319,954	80.0
Tianye Plant	570,228	109.7	583,650	112.2	491,322	94.5	159,664	122.8	300,028	115.4

(1) Equal to the percentage of actual annual production volume over designed annual production capacity. According to the industry norm in China for the urea industry, the designed annual production capacity is measured as daily production capacity multiplied by 300 days per year or 150 days per half year.

(2) In 2003, facilities at Fudao Phase II were in trial operation and all revenues generated by Fudao Phase II in 2003 were used to partially offset the cost of testing its functionality during the trial operation period.

(3) Equal to the percentage of actual annual production volume over designed annual production capacity. According to the industry norm in China for the urea industry, the designed annual production capacity is also measured as daily production capacity multiplied by 90 days per quarter.

In 2005, we suspended production of Fudao Phase I for 22 days in order to perform scheduled major maintenance of its facilities. Fudao Phase I and Fudao Phase II suspended production for 19 days and 24 days, respectively, to perform major maintenance during the three months ended 31 March 2006. In 2005, Tianye Chemical suspended its production for 77 days while it converted its facilities from oil-based production to natural gas-based production, which impacted its utilization rate. Our utilization rate may be affected by: (i) repair and maintenance that suspends our production; (ii) interruptions or stoppages of raw material supplies resulting from malfunction of natural gas production and/or transportation facilities; (iii) interruption of electricity power supply; and (iv) natural disasters such as typhoons.

We produced 602,373 tonnes, 1,412,939 tonnes, 1,361,013 tonnes and 273,694 tonnes of urea for the years ended 31 December 2003, 2004 and 2005 and the three months ended 31 March 2006, respectively, at our Hainan facilities while Tianye Chemical produced 570,228 tonnes, 583,650 tonnes, 491,322 and 159,664 tonnes of urea in the same periods.

In the years ended 31 December 2003, 2004 and 2005, we sold 572,276 tonnes, 1,379,906 tonnes and 1,364,607 tonnes of urea products, and generated revenues of RMB666.0 million, RMB1,914.0 million and RMB2,224.7 million, respectively, of which approximately 56.2%, 58.6% and 84.2% were from domestic urea sales. Tianye Chemical sold 543,015 tonnes, 664,509 tonnes and 489,239 tonnes of traditional prill urea and generated revenues of RMB591.3 million, RMB840.1 million and RMB740.5 million, respectively; substantially all of Tianye Chemical's sales during the years ended 31 December 2003, 2004 and 2005 were domestic sales. In the three months ended 31 March 2006, we, including Tianye Chemical, sold 455,572 tonnes of urea, and generated revenues of RMB657.9 million, of which 100% were from domestic sales.

Average Selling Price

The prices of urea products are generally determined by supply and demand in the domestic market, raw material costs and the PRC Government's imposition of price controls in the fertilizer industry. In the three years ended 31 December 2005, the average selling prices per tonne for urea products of both our Company and Tianye Chemical increased steadily due primarily to an increase in market demand. This increase was a result of both a continued decline in available farmland that has made it essential for China to raise its agricultural products yield to ensure adequate food supply and the PRC Government's policy encouraging the use of fertilizers. The price increase was also caused by the increase in prices of natural gas as a key raw material of urea in China and elsewhere in the world. The fertilizer prices in 2005 reached a historical high and declined slightly in the second half of 2005. There is no assurance that the prices will remain at recent or current levels or that they will increase in the future. Presently, domestic fertilizer prices are regulated by the PRC Government in the form of price ceilings, which affect our results of operations. The price ceiling limits price increases, while encouraging farmers to consume more fertilizers than they otherwise would, thus mitigating some of the negative effects of the price ceilings.

The ex-factory prices of urea products in the PRC have been regulated since 1998 and subject to price controls imposed by the PRC Government since 2004. At present, all fertilizer producers operating ammonia production facilities of over 150,000 tonnes per annum in China, or large- and middle-scale nitrogenous fertilizer producers, including us, are subject to a 15% upward ceiling for price adjustment based on a base price prescribed by the NDRC of RMB1,500 per tonne. Prior to 1 January 2006, however, both we and Tianye Chemical, as large-scale nitrogenous fertilizer producers, were subject to a 10% limitation on upward price adjustments based on applicable base prices which were prescribed by the NDRC or the relevant local development and reform commission from time to time. Export sales of urea products are not subject to price controls but the PRC Government has imposed seasonal export tariffs since 1 January 2005. The following table sets forth the average prices of our granular urea products produced in Hainan during the Track Record Period and for the six months ended 30 June 2006:

	2003	2004		2005		Three months ended 31 March 2006		Six months ended 30 June 2006	
	RMB (per tonne)	RMB (per tonne)	Year on year change %	RMB (per tonne)	Year on year change %	RMB (per tonne)	Period on period change %	RMB (per tonne)	Period on period change %
NDRC base price(1)	1,400	1,400(2)	—	1,500	7.1	1,500	—	1,500	—
Average Domestic sales price	1,287	1,476	14.7	1,650	11.8	1,591	(3.6)	1,649	(0.7)
Average Export sales price	1,352	1,666	23.2	2,030	21.8	—	—	2,229	9.8

(1) In 2004 and 2005, the sales price of urea was subject to a ceiling of 10% above the base price. This has been adjusted to 15% since January 2006.

(2) NDRC adjusted the base price to RMB1,500 per tonne from December 2004.

The following table sets forth the average prices of Tianye Chemical's traditional prill urea products during the Track Record Period and for the six months ended 30 June 2006:

	2003	2004		2005		Three months ended 31 March 2006		Six months ended 30 June 2006	
	RMB (per tonne)	RMB (per tonne)	Year on Year change %	RMB (per tonne)	Year on Year change %	RMB (per tonne)	Period on period change %	RMB (per tonne)	Period on period change %
NDRC based price(1)	1,400	1,400(2)	—	1,500	7.1	1,500	—	1,500	—
Average Domestic sales price	1,230	1,429	16.2	1,634	14.3	1,593	(2.5)	1,642	0.5

(1) In 2004 and 2005, the sales price of urea was subject to a ceiling of 10% above the base price. This has been adjusted to 15% since January 2006.

(2) NDRC adjusted the base price to RMB1,500 per tonne from December 2004.

Cost of Raw Materials

The main components of our and Tianye Chemical's cost of sales during the Track Record Period were the cost of raw materials. During the Track Record Period, we used natural gas as the primary raw material in our production facilities in Hainan. Tianye Chemical used residual oil as the primary raw material in its production facilities in Inner Mongolia before it converted from oil-based to natural gas-based production in October 2005. Natural gas accounted for approximately 39.6%, 45.3%, 41.2% and 38.5% of our costs of sales in the three years ended 31 December 2003, 2004 and 2005 and the three months ended 31 March 2006. Our primary sources of natural gas have historically been the offshore gasfields in basins surrounding Hainan Island which are operated by CNOOC Limited.

Crude oil prices, inflation and various other factors impact natural gas prices. Given the significance of raw materials to our total operating expenses and our limited ability to control these costs as compared to other operating costs, the volatility of these costs can materially affect our profit margins. In addition, because of the price controls imposed by the PRC Government, our ability to pass along price increases in the raw materials we use to our customers is limited.

We have entered into long-term natural gas sale and purchase agreements on a take-or-pay basis with CNOOC Limited, our affiliate, and Fuel & Chemical Corporation of Hainan, an Independent Third Party, to secure stable and reliable supplies of natural gas for our production in Hainan. Pursuant to such take-or-pay arrangement, CNOOC Limited and Fuel & Chemical Corporation of Hainan (as applicable) are obliged to supply, and we are obliged to purchase, a minimum quantity of gas each year. Under the terms of our natural gas sale and purchase agreements, the price at which natural gas is supplied to our production facilities in Hainan is subject to upward or downward adjustments on a quarterly or monthly basis with the frequency of such adjustments and specific adjustment formulae varying between agreements, and by reference to the average price of four major types of crude oil in the international markets during the preceding quarter or month as compared to the historical moving average of the four crude oil prices in the preceding years, subject to caps and floors as agreed upon in the agreements. During the Track Record Period, the caps (but not the floors) in relation to the natural gas prices in the agreements had been regularly triggered primarily because of the general increase trend in crude oil prices in the international markets.

Taking into account the regular triggering of price caps during the Track Record Period, the changes in average natural gas prices are as follows: In respect of Fudao Phase I, the average natural gas prices increased by approximately 7.7% from 2003 to 2004 and approximately 3.9% from 2004 to 2005, while the increase was about 3.1% from the first six months of 2005 to the first six months of 2006. The average natural gas prices for Fudao Phase II increased by approximately 3.0% from 2003 to 2004, 4.0% from 2004 to 2005 and 3.9% from the first six months of 2005 to the first six months of 2006.

Before 2005, Tianye Chemical used residual oil as the primary raw material in its production facilities. In October 2005, Tianye Chemical completed technical renovations to convert its facilities from oil-based to natural gas-based production. After the conversion, Tianye Chemical has been able to save approximately RMB255 from its budgeted material cost for the production of every tonne of urea. To secure natural gas supply, Tianye Chemical entered into a contract renewable annually with Inner Mongolia Western Natural Gas Co., Ltd. on 29 March 2005 to purchase natural gas for urea and methanol production. The price of natural gas supplied to Tianye Plant is subject to the PRC Government's pricing controls applicable to sales of natural gas sourced from onshore gasfields in the PRC.

Taxation

Corporate income tax

We enjoy substantial income tax reductions under various tax incentive programs applicable to our Company and/or some of our subsidiaries on a stand-alone basis. Although the standard corporate income tax rate in the PRC is 33%, businesses incorporated in Hainan Special Economic Zone, including ours and those of many of our subsidiaries, are entitled to a 15% corporate income tax rate. A two-year income tax exemption followed by a three-year 50% corporate income tax rate reduction based on a corporate income tax rate of 15% commencing from the first profitable year is commonly applicable to all members of our Company in Hainan. In addition, by virtue of its operation of Fudao Phase II, our Company is entitled to a further three-year 50% corporate income tax rate reduction with respect to the profits generated by our Company from the production of Fudao Phase II as it is qualified as an advanced and new technology project. Moreover, our subsidiary Hainan Basuo is entitled to a five-year corporate income tax exemption followed by a five-year 50% tax reduction of corporate income tax starting from 2005 due to its nature as an infrastructure development and operation business. CNOOC Jiantao, as a Sino-foreign joint venture, is entitled to a two-year exemption from corporate income tax starting from the first year of profit making, followed by a three-year 50% reduction of the corporate income tax rate of 15%. Tianye Chemical is entitled to preferential income tax treatment by way of a three-year exemption from corporate income tax rate of 33% starting from 2005 because it converted its facilities to use natural gas instead of residual oil as a raw material for its urea production. Fudao Phase I enjoyed a 50% corporate income tax rate reduction for 2003 and 2004.

The table below sets out the corporate income tax rates of the key members of our Company which were entitled to preferential tax treatments during the Track Record Period and thereafter:

	2003	2004	2005	2006
Fudao Phase I	7.5%	7.5%	15.0%	15.0%
Fudao Phase II	—	0.0%	0.0%	7.5%
Hainan Basuo	—	—	0.0%	0.0%
CNOOC Jiantao	—	—	—	—(1)
Tianye Chemical	33.0%	33.0%	0.0%	0.0%

(1) CNOOC Jiantao did not commence trial operation of its methanol plant until September 2006.

As a result of the preferential tax treatment, our effective tax rate for the years ended 31 December 2003, 2004 and 2005 and the three months ended 31 March 2006 was 9.4%, 3.4%, 4.6% and 2.3%, respectively.

Value added tax on domestic sales

During the Track Record Period, sales of our and Tianye Chemical's urea products were generally subject to a 13% value-added tax. However, the PRC Government has implemented a series of preferential VAT policies toward sales of urea products since 2001, including VAT exemptions and VAT refunds. The PRC Government stopped granting VAT exemptions or refunds in 2003. From January 2004 to June 2005, the PRC Government again began to refund 50% of the VAT paid by nitrogenous fertilizer producers, including VAT paid by us and by Tianye Chemical, after VAT had been paid in full. Starting from 1 July 2005, PRC fertilizer producers including both we and Tianye Chemical were completely exempt from VAT payment again. In the case of VAT exemption, output VAT otherwise payable by us and Tianye Chemical respectively is added into the sales revenue and input VAT that we and Tianye Chemical already paid is recorded as cost of sales. Thus, gross profit will increase by the amount of output VAT net of input VAT. However, in the case of VAT refunds, we and Tianye Chemical are required to pay output VAT in full, and the tax authority refunds a proportional amount of output VAT, which we record as other income and gains when there is reasonable assurance that we will receive the VAT refund.

Value added tax and tariffs on export sales

The PRC Government's tax regime for exports is subject to constant change. While we previously enjoyed 100% VAT refunds for exports of our urea products, we no longer receive such refunds and are instead subject to a seasonal export tariff ranging from 15% to 30% of the total export sales depending on the season when we make export sales. In 2005, the PRC Government completely ceased granting VAT refunds on exports of urea products, and at the same time reinstated export tariffs on the export of fertilizers. The PRC Government consequently announced on 25 May 2005 that effective immediately, fertilizer exports were no longer subject to export custom duties at the rate of RMB260 per tonne; instead, between 1 June 2005 and 31 October 2005, all fertilizer exports were subject to seasonal export tariffs. Beginning 1 June 2005, all fertilizer exports were subject to a seasonal export tariff at the rate of 30%. A 15% seasonal export tariff was in effect from 1 November 2005 to 31 December 2005, while a 30% seasonal export tariff has been in effect again since 1 January 2006 and will continue until 30 September 2006. The PRC Government has announced that the seasonal export tariff will be adjusted to 15% starting from 1 October 2006 until the end of 2006.

New or increased tax credits and other benefits and incentives or termination of or reduced tax benefits and incentives applicable to any of our subsidiaries and/or our Company may impact our financial results.

Seasonality and Adverse Weather Conditions

Sales of mineral fertilizer products are subject to seasonal fluctuations. Other than in southern China, we generate a higher proportion of revenue in spring and summer when fertilizer sales are at their peak, while in southern China such sales peaks are less pronounced. However, during the Track Record Period, we adjusted our sales and marketing strategies to mitigate some of the fluctuations in our revenue by making export sales to Australia and New Zealand in the southern hemisphere and Southeast Asia during the off-peak season in China. Nevertheless, as a result of these seasonal fluctuations, our operating results may vary substantially between financial quarters. In addition, quarterly results may also vary significantly from one year to the next due primarily to weather-related shifts in planting schedules. Adverse weather conditions or other natural disasters, such as droughts or floods, affecting one or more agricultural regions in China, could also have a negative effect on fertilizer demand either locally or throughout China. This could, in turn, adversely affect our operating results and financial condition.

Critical Accounting Policies and Practices

Tianye Chemical shares our critical accounting policies and practices for the preparation of its financial information. The discussion and analysis of our and Tianye Chemical's operating results and financial condition are based on our and Tianye Chemical's audited financial information, which have been prepared in accordance with IFRS. Our and Tianye Chemical's operating results and financial condition in the Track Record Period and in the future are sensitive to accounting methods, assumptions and estimates that underlie the preparation of our and Tianye Chemical's financial information. We base these assumptions and estimates on our industry experience and on various other factors, including expectations of future events that our management teams believe to be reasonable. We evaluate these estimates on an ongoing basis. Actual results may differ from these estimates as facts, circumstances and conditions change or as a result of different assumptions adopted by our management in reviewing our financial performance and preparing our financial statements.

Our management team considers the following factors in reviewing the respective consolidated financial information:

- the selection of critical accounting policies; and
- the judgments and other uncertainties affecting the application of those critical accounting policies.

The selection of critical accounting policies, the judgments and other uncertainties affecting the application of those policies, as well as the sensitivity of reported results to changes in conditions and assumptions, are all factors to be considered when reviewing our and Tianye Chemical's audited financial information. Our significant accounting policies are summarized in Section 2 to the Accountants' Report of our Company in Appendix IA to this Prospectus. The significant accounting policies of Tianye Chemical are summarized in Section 2 to the Accountants' Report on Tianye Chemical in Appendix IB to this Prospectus. We believe the following critical accounting policies and practices involve a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities.

Jointly-controlled Entity

A jointly-controlled entity is a company established by contractual agreement between our Company and other parties which is subject to joint control, resulting in none of the participating parties having unilateral control over the activities of the jointly-controlled entity.

Our investments in the joint-controlled entity are accounted for by proportionate consolidation, which involves recognizing a proportionate share of the joint venture's assets, liabilities, income and expenses with similar items in the financial statements of our Company on a line-by-line basis. When the profit sharing ratio is different to our equity interests in the jointly-controlled entity, our share of their assets, liabilities, income and expenses is determined based on the agreed profit sharing ratio.

The results of our jointly-controlled entity are included in our income statement to the extent of dividends received and receivable. Our investments in our jointly-controlled entity are treated as long-term assets and are stated at cost less any impairment losses.

Property, Plant and Equipment

In accounting for property, plant and equipment, we make estimates about the expected useful lives of the assets, the expected residual value of the assets, and the potential for impairment based on the higher of their value in use and their fair value less costs to sell.

The following table shows a breakdown of our property, plant and equipment along with information about their estimated useful lives:

Asset	Estimated useful life
Buildings	15 to 35 years
Plant and equipment	5 to 14 years

We review the carrying values of the property, plant and equipment for impairment when events or circumstances indicate the carrying value may not be recoverable. Factors that would indicate potential impairment may include, but are not limited to, significant decreases in the market value of the property, plant and equipment, a significant change in the asset's physical condition, and operating or cash flow losses associated with the use of the property, plant and equipment. Impairment losses are recognized in the income statement.

There is an inherent risk in estimating the future cash flows used in the impairment test. If the cash flows do not materialize as estimated, there is a risk the impairment charges recognized to date may be inaccurate, or further impairment charges may be necessary in the future.

Allowance for doubtful debts

We generally require all of our customers to make full payment before delivery of products except for those who are able to present credible commercial acceptance drafts for domestic sales. At present, we only accept commercial acceptance drafts from customers who are also our shareholders, including Guangdong AMP, Shanghai AMP and Zhejiang AMP. We base such estimates on our historical experience, existing economic conditions and any specific customer collection issues we have identified. Circumstances in some of the industries in which our customers operate may affect their operating performance and cash flows, which in turn may affect our ability to collect our accounts receivables. As circumstances develop, the financial condition of specific customers changes or additional information becomes available, adjustments to the allowance for doubtful debts may be required.

Deferred tax

Deferred tax is provided in full, using the liability method, on all significant temporary differences arising between the tax base of assets and liabilities and their carrying amounts at the balance sheet date. We record a valuation allowance, when appropriate, to adjust deferred tax asset balances to the amount we expect to realize. We consider, as applicable, the amount of taxable income available in carryback years, future taxable income and potential tax planning strategies in assessing the potential need for a valuation allowance. We will require future taxable income in order to fully realize our net deferred tax assets. Should we determine that we will not likely realize all or part of our net deferred tax assets in the future, an adjustment to the deferred tax asset balance would be charged to the income tax expense in the period such determination is made.

Description of Components of Results of Operations

Revenue

The following tables break down the sources of revenue of our Company and Tianye Chemical for the periods indicated:

	Year ended 31 December						Three months ended 31 March			
	2003(2)		2004(2)		2005(2)		2005(2)		2006(3)	
Our Company	RMB (million)	%	RMB (million)	%	RMB (million)	%	RMB (million) (unaudited)	%	RMB (million)	%
Fertilizer operations(1)	709.8	96.2	1,962.2	96.8	2,259.9	95.3	486.8	96.3	662.4	94.9
Other(4)	28.4	3.8	65.1	3.2	111.1	4.7	18.8	3.7	35.3	5.1
Total	738.2	100.0	2,027.3	100.0	2,371.0	100.0	505.6	100.0	697.7	100.0

	Year ended 31 December					
	2003		2004		2005	
Tianye Chemical	RMB (million)	%	RMB (million)	%	RMB (million)	%
Fertilizer operations	591.3	99.4	840.1	99.5	740.5	99.3
Other	3.8	0.6	4.3	0.5	4.9	0.7
Total	595.1	100.0	844.4	100.0	745.4	100.0

(1) Figures include sales of granular urea and compound fertilizer sold to external customers and in 2006 traditional prill urea.

(2) Figures do not include revenues of Tianye Chemical.

(3) Figures include revenues of Tianye Chemical from 19 January 2006 onwards.

(4) Figures mainly include revenues from transportation services and port operations we provided to external customers.

During the Track Record Period, we generated sales revenue mainly from external sales of fertilizer products, mainly consisting of granular urea and compound fertilizer products prior to the Acquisition. After the Acquisition, we also generated revenues from sales of traditional prill urea produced at Tianye Plant. In addition, we generated service revenue from the provision of logistics services, including port operations and transportation services to external customers. Although methanol operations comprise one of our business segments, we did not generate any revenue from the production and sale of methanol during the Track Record Period because CNOOC Jiantao Methanol Plant was not in operation during the Track Record Period and Tianye Chemical did not commence mass production of methanol until April 2006.

For the years ended 31 December 2003, 2004 and 2005, Tianye Chemical generated sales revenue mainly from its external sales of traditional prill urea products. Although Tianye Chemical also operated in the methanol segment, it did not generate any revenue from the production and sales of methanol because its new methanol plant did not commence mass production until April 2006.

The sales represent the sales amount net of value-added taxes and discounts after elimination of transactions with companies comprising our Company and Tianye Chemical, respectively. Since 1 July 2005, the PRC Government implemented a VAT exemption policy towards urea products; thus, we and Tianye Chemical were completely exempt from VAT payment. In the case of VAT exemption, output VAT otherwise payable by us and Tianye Chemical respectively is added into the sales revenue and input VAT that we and Tianye Chemical already paid is recorded as cost of sales.

Cost of Sales

Cost of sales for the fertilizer, methanol and other operations represents the direct costs of production, which primarily include raw materials costs, manufacturing overheads and direct staff costs, adjusted for changes in finished goods. Under IFRS, input VAT with respect to the VAT exemption already paid for raw materials is recorded as cost of sales.

Other Income and Gains

Other income and gains mainly consist of fair value gains on derivative financial instruments and government grants and subsidies, such as VAT refunds. Prior to 1 July 2005, we and Tianye Chemical were required to pay VAT in full on a bi-monthly basis. The tax authority refunds proportional VAT, which we record as other income when there is reasonable assurance that we will receive the VAT refund. Other income and gains also include revenues from sales of chemical materials for the production of our products on an irregular basis, sales of scrap materials and resale of electricity and water to third parties.

In addition, gains arising from changes in the fair value of a cross-currency interest rate swap contract (the "swap") also constitute other income and gains. The swap is a combination of an interest-rate swap and a currency swap. It is an agreement to exchange a fixed interest rate in one currency for a floating interest rate in another currency. In order to reduce the exposure to the interest rate and exchange rate fluctuation from our Japanese Yen denominated bank loan (the "Yen Loan"), which we borrowed to finance construction of Fudao Phase II and a Japanese Yen denominated bank loan for Tianye Chemical, we entered into the swap with Bank of China Hainan branch to swap the Japanese Yen cash flow arising from the Yen Loan into U.S. dollar cash proceeds and payments at a fixed interest rate of 3.93% per annum, the term of the swap is from 10 May 2001 to 20 June 2008 which covers only part of the term of the Yen Loan. Pursuant to the swap agreement, the timing and amount of Japanese Yen cash payments and proceeds are scheduled to match the Yen Loan disbursement and repayment schedule. For the period from 10 May 2001 to 20 June 2005, which was the draw down period of the Yen Loan, we paid Japanese Yen proceeds from the Yen Loan and received U.S. dollars at the pre determined exchange rate of JPY/U.S.$=124. From 20 June 2005 to 20 June 2008, which is the repayment period of the Yen Loan, under the swap, we pay the interest and principal in U.S. dollars and receive interest and principal in Japanese Yen, which we use to repay the Yen Loan. During this period, the notional principal of the two currencies decrease on straight line basis corresponding to the repayment schedule on the Yen Loan.

Selling and Distribution Costs

Selling and distribution costs for our Company consist primarily of transportation costs for delivery of products from the production complex to the port and port charges, which we incur only when export sales on an FOB basis are involved. All our sales to domestic customers are on an ex-factory basis, so that we incur limited transportation expenses.

Selling and distribution costs for Tianye Chemical comprise primarily miscellaneous transportation costs. Selling and distribution costs for our Company and Tianye Chemical also include salaries and benefits for sales and marketing staff, and expenses relating to the maintenance and operation of transportation vehicles.

Administrative Expenses

Administrative expenses consist primarily of the salaries and benefits of administrative and management staff, and the depreciation of non-production related property, plant and equipment.

Excess over the cost of a Business Combination

Due to the Acquisition, we recorded RMB577.6 million for the three months ended 31 March 2006 as excess over the cost of a business combination, which represents the excess of our interest in the net fair value of Tianye Chemical's identifiable assets, liabilities and contingent liabilities over the cost of the Acquisition.

Inner Mongolia Finance Bureau assumed 50% of the interest-bearing bank loans denominated in Japanese Yen borrowed from the Export-Import Bank of China by Tianye Chemical together with the penalty interest payable and late fee payables thereon (collectively, the "Japanese Yen Loan Obligations") in connection with our Acquisition of Tianye Chemical in early 2006. In addition, the Inner Mongolia Finance Bureau has waived 50% of the amount due to it by Tianye Chemical as of 31 December 2005 arising from its previous settlement of part of the Japanese Yen Loan Obligations on behalf of Tianye Chemical. At the completion of the mentioned loan obligation assumption and the waiver, the Japanese Yen Loan Obligations was reduced to RMB898.5 million. The effect of the assumption and the waiver was taken into consideration in determining the fair value of the net identifiable assets of Tianye Chemical on the date of the Acquisition, thereby giving rise to a significant amount of excess over the cost of a business combination recognized in the Acquisition.

Other Expenses

Other expenses mainly comprise losses realized from, or arising from changes in fair value of, the swap.

Finance Revenue

Finance revenue comprises interest income received from our and Tianye Chemical's bank deposits.

Finance Costs

Finance costs of our Company and Tianye Chemical include interest on bank and other borrowings less interest capitalized.

Exchange gain/(loss), net

Our exchange gains and losses consist primarily of the gains or losses resulting from the fluctuation of Japanese Yen against Renminbi as our and Tianye Chemical's functional currency in connection with our and Tianye Chemical's Japanese Yen denominated bank loans.

Income Tax Expenses

Our Company

We enjoy substantial income tax reductions under various tax incentive programs applicable to our Company and/or some of our subsidiaries on a stand-alone basis. Although the standard corporate income tax rate in the PRC is 33%, businesses incorporated in Hainan Special Economic Zone, including ours and those of many of our subsidiaries, are entitled to a 15% corporate income tax rate. A two-year income tax exemption followed by a three-year 50% corporate income tax rate reduction based on a corporate income tax rate of 15% commencing from the first profitable year is commonly applicable to all members of our Company in Hainan. In addition, by virtue of its operation of Fudao Phase II, our Company is entitled to a further three-year 50% corporate income tax rate reduction with respect to the profits generated from Fudao Phase II as it is qualified as an advanced and new technology project. Moreover, our subsidiary Hainan Basuo is entitled to a five-year corporate income tax exemption followed by a five-year 50% tax reduction of corporate income tax starting from 2005 due to its nature as an infrastructure development and operation business. CNOOC Jiantao, as a Sino-foreign joint venture, is entitled to a two-year exemption from corporate income tax starting from the first year of profit making, followed by a three-year 50% reduction of the corporate income tax rate of 15%. Tianye Chemical is entitled to preferential income tax treatment by way of a three-year exemption from the corporate income tax rate of 33% starting from 2005 because it converted its facilities to use natural gas instead of residual oil as a raw material for its urea production. Fudao Phase I enjoyed a 50% corporate income tax rate reduction for 2003 and 2004.

Our effective consolidated income tax rates were 9.4%, 3.4%, 4.6% and 2.3% for the years ended 31 December 2003, 2004 and 2005 and the three months ended 31 March 2006, respectively.

Tianye Chemical

Without taking into account the preferential tax treatment for corporate income tax, Tianye Chemical was subject to corporate income tax at the rate of 33% during the Track Record Period. Tianye Chemical is, however, entitled to a three-year tax exemption starting from 2005 because of the conversion of its facilities from residual oil-based to natural gas-based production in 2005. Movements in deferred tax provision on items such as impairment of assets was recorded by Tianye Chemical as income tax credit.

The effective consolidated income tax rates of Tianye Chemical were 4.7%, (24.6)% and (0.0)% for the years ended 31 December 2003, 2004 and 2005, respectively.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF CERTAIN UNAUDITED FINANCIAL INFORMATION FOR THE SIX MONTHS ENDED 30 JUNE 2006

Our interim financial results for the six months ended 30 June 2005 and the six months ended 30 June 2006 are unaudited but have been reviewed by our auditors, Ernst & Young, Certified Public Accountants, Hong Kong in accordance with Statement of Auditing Standards 700 "Engagements to review interim financial reports" issued by the Hong Kong Institute of Certified Public Accountants. The independent review report on such financial results is included in this Prospectus as Appendix IC. Our Audit Committee has reviewed such interim financial report and has also reviewed together with the management the accounting principles, practices adopted by us and discussed our internal control and financial reporting matters. We believe the interim financial report includes all adjustments, consisting of normally recurring accruals, necessary for a fair presentation of the results for the relevant periods. However, we consolidated the operating results of Tianye Chemical from 19 January 2006 to 30 June 2006. As a result, our operating results for the six months ended 30 June 2006 are not comparable to the six months ended 30 June 2005. In addition, prospective investors who read the information should bear in mind that the operating results for the six months ended 30 June 2006 are not necessarily indicative of results to be expected for the full year.

As all relevant information relating to our interim results for the six months ended 30 June 2006 is set out in this Prospectus, we will not separately issue a preliminary announcement of our interim results or an interim report for the same period.

Consolidated Income Statement

The following table sets forth, for the periods indicated, information relating to certain income and expense items and percentages from our condensed consolidated income statements for the six months ended 30 June 2005 and 2006:

	Six months ended 30 June			
	2005		2006	
	RMB	%	RMB	%
	(in millions, except for earnings per share) (Unaudited)			
Revenue	1,132.3	100.0	1,613.8	100.0
Cost of sales	(623.0)	(55.0)	(993.0)	(61.5)
Gross profit	509.3	45.0	620.8	38.5
Other income and gains	1.1	0.1	118.3	7.3
Excess over the cost of a business combination	—	—	577.6	35.8
Selling and distribution costs	(4.6)	(0.4)	(10.1)	(0.6)
Administrative expenses	(47.9)	(4.2)	(92.0)	(5.7)
Other expenses	(58.7)	(5.2)	(22.6)	(1.4)
Finance revenue	8.4	0.7	11.8	0.7
Finance costs	(8.3)	(0.7)	(27.9)	(1.7)
Exchange gain/(loss), net	79.0	7.0	(12.5)	(0.8)
Share of profits of associates	1.0	0.1	1.1	0.1
Profit before tax	479.3	42.4	1,164.5	72.2
Income tax expense	(22.2)	(2.0)	(56.0)	(3.5)
Profit for the period	457.1	40.4	1,108.5	68.7
Profit for the period attributable to equity holders of the parent	437.0	38.6	1,084.8	67.2
Basic earnings per share attributable to ordinary equity holders of the parent (cents)	14.57		36.16	

Six Months Ended 30 June 2006 Compared With Six Months Ended 30 June 2005

Revenue

Our revenue increased by 42.5% from RMB1,132.3 million for the six months ended 30 June 2005 to RMB1,613.8 million for the six months ended 30 June 2006, due primarily to the contribution from Tianye Chemical amounting to RMB510.9 million after the Acquisition.

Hainan Basuo was established on 25 April 2005. Therefore, our financial results in the first half of 2005 reflect only slightly over two months of its operations, while our financial results in the first half of 2006 reflect six months of Hainan Basuo's operations. This difference resulted in an increase of RMB18.3 million in revenue in the six months ended 30 June 2006 compared to the same period in 2005.

Without considering the contributions from Tianye Chemical and Hainan Basuo, revenue from our Hainan urea facilities remained almost unchanged from the first half of 2005 due to the decrease in production volumes and sales volumes as a result of the major maintenance that took place in the first quarter of 2006, offset by our entitlement to the VAT exemption.

In the six months ended 30 June 2006, we produced 604,754 tonnes and sold 620,097 tonnes of urea at our Hainan facilities, approximately 85,246 tonnes and 85,507 tonnes less, respectively, compared to the same period in 2005 due mainly to the major scheduled maintenance we performed during the first half of 2006. We performed major scheduled maintenance at both Fudao Phase I and Fudao Phase II in the first quarter of 2006. As a result, Fudao Phase I suspended production for 19 days and Fudao Phase II suspended production for 24 days.

The impact of the substantial decline in production and sales volumes on our revenue was offset by our entitlement to the VAT exemption. Since 1 July 2005, the PRC Government implemented a VAT exemption policy towards sales of urea products in China. We, excluding Tianye Chemical, recorded RMB116.3 million output VAT otherwise payable as revenue in the six months ended 30 June 2006. Before the implementation of such VAT exemption policy, no output VAT was recorded as revenue in the six months ended 30 June 2005.

Cost of sales

Our cost of sales increased by 59.4% from RMB623.0 million for the six months ended 30 June 2005 to RMB993.0 million for the six months ended 30 June 2006. Our cost of sales was 61.5% of the revenue for the six months ended 30 June 2006 compared to 55.0% for the six months ended 30 June 2005. Tianye Chemical's cost of sales amounted to RMB358.1 million from 19 January to 30 June 2006, contributing 36.1% to our cost of sales for the current period after the Acquisition. We incurred depreciation costs of RMB127.8 million and RMB226.6 million in the six months ended 30 June 2005 and the six months ended 30 June 2006, respectively, for our production facilities, which was recorded in the cost of sales.

Since 1 July 2005, the PRC Government implemented a VAT exemption policy towards urea products sold in China. Although the major scheduled maintenance of Fudao Phase I and Fudao Phase II resulted in a decrease in production volume of 85,246 tonnes, without considering Tianye Chemical's cost of sales, our cost of sales for the six months ended 30 June 2006 increased by 1.9% compared to that of the same period in 2005. This was primarily due to the increase in expenses of approximately RMB30.0 million incurred for major maintenance and input VAT of RMB34.0 million we recorded as cost of sales due to VAT exemption, the effect of which was substantially offset by the decrease in production cost due to lower production volumes. In addition, as Hainan Basuo was established in April 2005, its contribution to cost of sales resulted in an increase of RMB12.3 million in our cost of sales in the six months ended 30 June 2006 compared to the same period in 2005.

Gross profit

As a result of the Acquisition, our gross profit increased by 21.9% from RMB509.3 million for the six months ended 30 June 2005 to RMB620.8 million for the six months ended 30 June 2006. However, our gross profit margin decreased to 38.5% in the six months ended 30 June 2006 from 45.0% for the six months ended 30 June 2005, mainly because of the major maintenance of Fudao Phase I and Fudao Phase II which resulted in higher unit cost of granular urea, and the higher unit cost of traditional prill urea produced by Tianye Chemical as a result of its comparatively higher unit depreciation and gas feedstock prices than those of our Hainan operations.

Other income and gains

Our other income and gains increased significantly from RMB1.1 million for the six months ended 30 June 2005 to RMB118.3 million in the six months ended 30 June 2006, mainly because we recorded a VAT refund regarding our sales made in the previous years of RMB89.3 million in the six months ended 30 June 2006 but no such refund was recorded in the six months ended 30 June 2005.

In addition, our Company recorded a fair value gain on the swap of RMB24.7 million in the six months ended 30 June 2006, while we recorded a fair value loss on the swap of RMB54.5 million which was recorded as other expenses in the six months ended 30 June 2005.

Excess over the cost of a business combination

Due to the Acquisition, we recorded RMB577.6 million for the six months ended 30 June 2006 as excess over the cost of a business combination, which represents the excess of our interest in the net fair value of Tianye Chemical's identifiable assets, liabilities and contingent liabilities over the cost of the Acquisition. We recorded nil excess over the cost of a business combination for the six months ended 30 June 2005.

Selling and distribution costs

Our selling and distribution costs increased by 119.6% from RMB4.6 million for the six months ended 30 June 2005 to RMB10.1 million for the six months ended 30 June 2006, mainly due to the addition of Tianye Chemical's selling and distribution costs for the six months ended 30 June 2006. Without considering Tianye Chemical's selling and distribution costs in the period, which amounted to RMB4.5 million, our selling and distribution costs for the six months ended 30 June 2006 were generally at a similar level as for the six months ended 30 June 2005.

Administrative expenses

Our administrative expenses increased by 92.1% from RMB47.9 million for the six months ended 30 June 2005 to RMB92.0 million for the six months ended 30 June 2006. This was due to (i) an increase of RMB25.2 million resulting from the consolidation of Tianye Chemical; (ii) an increase of RMB7.1 million due to the fact that we consolidated the operating results of Hainan Basuo only since May 2005 when it was established; and (iii) a general increase in various administrative expenses.

Other expenses

Our other expenses decreased by 61.5% from RMB58.7 million for the six months ended 30 June 2005 to RMB22.6 million for the six months ended 30 June 2006 mainly because we recorded a fair value loss on the swap of RMB54.5 million in the six months ended 30 June 2005, while we recorded no such loss for the six months ended 30 June 2006. We incurred a loss of approximately RMB19.0 million with respect to the swap upon our scheduled repayment of the Japanese Yen denominated bank loan in June 2006.

Finance revenue

Our finance revenue increased by 40.5% from RMB8.4 million for the six months ended 30 June 2005 to RMB11.8 million for the six months ended 30 June 2006. The increase in finance revenue was primarily due to a higher level of consolidated average bank deposits for the six months ended 30 June 2006 than for the six months ended 30 June 2005 due to the net profit we generated for the six months from July to December 2005 and the consolidation of Tianye Chemical from 19 January 2006.

Finance costs

Our finance costs increased substantially from RMB8.3 million for the six months ended 30 June 2005 to RMB27.9 million for the six months ended 30 June 2006. The increase in finance costs was primarily because we repaid half of Tianye Chemical's Japanese Yen bank loans on behalf of Tianye Chemical as a result of the Acquisition, and we obtained entrusted loans in the amount of RMB1.4 billion from CNOOC in late February and early March 2006 at an effective interest rate of 5.22% per annum. Details of the entrusted loans from CNOOC have been set out in note 6(v) "Other payables and accruals" to the Accountants' Report set out in Appendix IA to this Prospectus. Such entrusted loans were subsequently refinanced through external bank borrowings in June 2006 as required by the Hong Kong Stock Exchange for the purpose of demonstrating our financial independence. See "Future Plans and Use of Proceeds—Use of Proceeds".

Exchange gain/(loss), net

We incurred a foreign exchange loss of RMB12.5 million for the six months ended 30 June 2006 primarily due to the exchange loss arising from the purchase of Japanese Yen to repay parts of the Japanese Yen loans. We recorded a foreign exchange gain of RMB79.0 million for the six months ended 30 June 2005 due primarily to the 3.1% depreciation of Japanese Yen against Renminbi from 31 December 2004 to 30 June 2005.

Share of profits of associates

Share of profits of associates for the six months ended 30 June 2006 amounted to RMB1.1 million, which represented a slight increase from our share of profits of associates of RMB1.0 million for the six months ended 30 June 2005.

Income tax expense

Our income tax expense increased by RMB33.8 million, or 152.3%, from RMB22.2 million for the six months ended 30 June 2005 to RMB56.0 million for the six months ended 30 June 2006. This increase was due primarily to the expiration of the exempted corporate income tax period of our Company with respect to the operation of Fudao Phase II. Profit before tax from Fudao Phase II was subject to 7.5% corporate income tax in 2006, compared to 0.0% in 2005; as a result, our income tax expense increased by RMB21.1 million in the six months ended 30 June 2006.

Our effective income tax rate was 4.6% for the six months ended 30 June 2005 and 4.8% for the six months ended 30 June 2006.

Profit for the period

As a result of the foregoing factors, our profit for the period increased by 142.5%, or RMB651.4 million, from RMB457.1 million for the six months ended 30 June 2005 to RMB1,108.5 million for the six months ended 30 June 2006.

Working Capital Management

Trade receivables

The average collection days for our trade receivables decreased substantially from 19.0 days as of 31 December 2005 to 11.7 days (on an annualized basis) as of 30 June 2006. The significant improvement in the average collection days for our trade receivables was because nearly all of our urea products were sold domestically in the first half of 2006 pursuant to arrangements under which the majority of our customers were required to pay in advance.

Inventory

Our average inventory turnover days decreased from 42.5 days in the year ended 31 December 2005 to 36.3 days (on an annualized basis) in the first six months in 2006. The decrease was mainly due to the continued improvement of our inventory management system.

Liquidity and Capital Resources

For the six months ended 30 June 2006, our principal cash requirements included capital expenditures related to the expansion of our production capacities, investments in subsidiaries and affiliates, and servicing of our indebtedness. During this period, we met a significant portion of our cash requirements with cash generated from operations, bank borrowings and other available lines of credit.

Cash used in our capital expenditures for the six months ended 30 June 2006 totaled RMB518.8 million. We incurred these expenditures in purchasing machinery and equipment.

Net cash generated from operating activities increased by 98.2% from RMB511.0 million for the six months ended 30 June 2005 to RMB1,012.9 million for the six months ended 30 June 2006. The increase of RMB501.9 million was attributable to: (i) an increase in operating profit before working capital changes from RMB588.9 million for the six months ended 30 June 2005 to RMB847.5 million for the six months ended 30 June 2006; and (ii) a decrease in trade and bills receivables, prepayments, deposits and other receivables amounting to RMB169.8 million for the six months ended 30 June 2006, compared to an increase amounting to RMB91.7 million mainly due to significantly reduced export sales which generally generate a substantial amount of trade receivables based on the terms of sales.

Net cash used in investing activities increased significantly from RMB318.4 million for the six months ended 30 June 2005 to RMB1,346.3 million for the six months ended 30 June 2006. The increase of RMB1,027.9 million was mainly attributable to the consideration paid for the Acquisition amounting to RMB892.2 million, net of the cash and cash equivalents acquired and RMB447.7 million used in the purchases of property, plant and equipment. The increases in net cash used in investing activities for the six months ended 30 June 2006 compared to the six months ended 30 June 2005 were partly offset by a decrease of RMB71.8 million in non-pledged time deposits with original maturity of three months or more when acquired for the six months ended 30 June 2006, compared to an increase of RMB274.0 million in non-pledged time deposits with original maturity of three months or more when acquired for the six months ended 30 June 2005.

In the six months ended 30 June 2006, we had net cash outflow for financing activities of RMB104.0 million, compared to net cash inflow for financing activities of RMB145.3 million for the six months ended 31 June 2005. The changes are primarily due to (i) our receipt of bank and other borrowings of RMB1,695.4 million; (ii) our repayment of RMB849.5 million bank and other borrowings to partially settle the Japanese Yen denominated loan in order to reduce our exposure to future Japanese Yen fluctuations; (iii) Tianye Chemical's repayment of RMB904.9 million in loans to the Inner Mongolia Finance Bureau for the six months ended 30 June 2006; and (iv) the dividend payment to minority shareholders of RMB50.6 million for the six months ended 30 June 2006. We had combined cash, cash equivalents and pledged bank deposits of approximately RMB1,575.7 million as of 30 June 2006.

As of 30 June 2006, we had RMB475.4 million as long-term interest-bearing bank and other borrowings outstanding and we had RMB1,660.3 million outstanding short-term interest-bearing bank and other borrowings.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS OF OUR COMPANY

The following discussion and analysis are related to our operation and financial conditions during the Track Record Period on a consolidated basis. Since we did not gain effective control of Tianye Chemical until 19 January 2006, we did not consolidate the operating results of Tianye Chemical for the years ended 31 December 2003, 2004, 2005 and the three months ended 31 March 2005 into ours. However, we consolidated the operating results of Tianye Chemical from 19 January 2006 to 31 March 2006. As a result, our operating results for the three months ended 31 March 2006 are not comparable to the operating results for the three months ended 31 March 2005 without considering the Acquisition.

For the discussion and analysis of Tianye Chemical's financial condition and results of operations, see "—Management's discussion and analysis of financial condition and results of operations of Tianye Chemical" in this section.

Consolidated Income Statement

The following table sets forth, for the periods indicated, information relating to certain income and expense items and percentages from our consolidated income statements:

Summary consolidated income statement data of our Company	Year ended 31 December						Three months ended 31 March			
	2003		2004		2005		2005		2006	
	RMB	%	RMB	%	RMB	%	RMB	%	RMB	%
	(in millions, except for percentages or otherwise marked)									
	(audited)						(unaudited)		(audited)	
Revenue	738.2	100	2,027.3	100	2,371.0	100	505.6	100	697.7	100
Cost of sales	(476.5)	(64.5)	(1,095.0)	(54.0)	(1,293.1)	(54.5)	(296.0)	(58.5)	(449.1)	(64.4)
Gross profit	261.7	35.5	932.3	46.0	1,077.9	45.5	209.6	41.5	248.6	35.6
Other income and gains	79.4	10.8	40.7	2.0	1.7	0.1	0.9	0.2	7.1	1.0
Excess over the cost of a business combination	—	—	—	—	—	—	—	—	577.6	82.8
Selling and distribution costs	(19.0)	(2.6)	(31.1)	(1.5)	(15.4)	(0.7)	(1.9)	(0.5)	(3.6)	(0.5)
Administrative expenses	(56.5)	(7.7)	(76.6)	(3.8)	(130.7)	(5.5)	(17.4)	(3.4)	(42.3)	(6.1)
Other expenses	(23.8)	(3.3)	(28.8)	(1.4)	(103.1)	(4.3)	(37.0)	(7.3)	(0.8)	(0.1)
Finance revenue	3.8	0.5	11.8	0.6	24.4	1.0	3.6	0.7	7.0	1.0
Finance costs	(7.7)	(1.0)	(15.0)	(0.7)	(15.5)	(0.7)	(4.1)	(0.8)	(10.7)	(1.5)
Exchange gain/(loss), net	(56.1)	(7.6)	(40.0)	(2.0)	189.5	8.0	41.9	8.3	(6.2)	(0.9)
Share of profits of associates	0.9	0.1	1.6	0.1	1.9	0.1	0.4	0.1	0.5	0.1
Profit before tax	182.7	24.7	794.9	39.3	1,030.7	43.5	196.0	38.8	777.2	111.4
Income tax expense	(17.2)	(2.3)	(26.9)	(1.3)	(47.5)	(2.0)	(3.2)	(0.6)	(17.7)	(2.5)
Profit for the year/period	165.5	22.4	768.0	38.0	983.2	41.5	192.8	38.2	759.5	108.9

Three Months Ended 31 March 2006 Compared with Three Months Ended 31 March 2005

Revenue

Our revenue increased by 38.0% from RMB505.6 million for the three months ended 31 March 2005 to RMB697.7 million for the three months ended 31 March 2006, due primarily to the contribution from Tianye Chemical amounting to RMB215.0 million after the Acquisition. Without considering the contribution from Tianye Chemical, our revenue decreased by RMB22.9 million.

The decrease was primarily due to the 39,811 tonne reduction of the sales volume of granular urea products in the three months ended 31 March 2006, compared to the three months ended 31 March 2005, caused by decreased production volumes. In the three months ended 31 March 2006, we produced 273,694 tonnes of urea at our Hainan facilities, approximately 21,080 tonnes less than our production in the three months ended 31 March 2005, because we performed major scheduled maintenance at both Fudao Phase I and Fudao Phase II. As a result, Fudao Phase I suspended production for 19 days and Fudao Phase II suspended production for 24 days. In addition, decreases in average selling prices (net of VAT) in the three months ended 31 March 2006 compared to the three months ended 31 March 2005 also contributed to the decrease in our revenue without considering the contribution of Tianye Chemical.

However, the decreases in our revenue due to decreased sales volume and selling prices were partly offset by our entitlement to the VAT exemption. Since 1 July 2005, the PRC Government implemented a VAT exemption policy towards sales of urea products sold in China. We recorded RMB51.3 million output VAT otherwise payable as revenue in the three months ended 2006. We recorded nil output VAT as revenue in the three months ended 2005.

Cost of sales

Our cost of sales increased by 51.7% from RMB296.0 million for the three months ended 31 March 2005 to RMB449.1 million for the three months ended 31 March 2006. Our cost of sales was 64.4% of revenue for the three months ended 31 March 2006 compared to 58.5% for the three months ended 31 March 2005. Tianye Chemical's cost of sales amounted to RMB144.0 million from 19 January to 31 March 2006, contributing 32.1% to our cost of sales for the current period after the Acquisition. We incurred depreciation costs of RMB63.3 million and RMB101.0 million in the three months ended 31 March 2005 and the three months ended 31 March 2006, respectively, for our production facilities, which was recorded in the cost of sales.

Since 1 July 2005, the PRC Government implemented a VAT exemption policy towards urea products sold in China. Although the major maintenance of Fudao Phase I and Fudao Phase II resulted in a decrease of 40,000 tonnes in sales volume, without considering Tianye Chemical's cost of sales, our cost of sales for the three months ended 31 March 2006 increased by 3.1% compared to that in the same period of 2005. This was primarily due to the increase of RMB30.0 million in expenses incurred for major maintenance and RMB17.9 million input VAT we recorded as cost of sales due to VAT exemption.

Gross profit

As a result of the Acquisition, our gross profit increased by 18.6% from RMB209.6 million for the three months ended 31 March 2005 to RMB248.6 million for the three months ended 31 March 2006. However, our gross profit margin decreased to 35.6% in the three months ended 31 March 2006 from 41.5% for the three months ended 31 March 2005, mainly because of the major maintenance of Fudao Phase I and Fudao Phase II which resulted in higher unit costs of granular urea, and the increase in unit cost of traditional prill urea due to Tianye Chemical's gas feedstock prices being higher than ours.

Other income and gains

We entered into a cross-currency interest rate swap contract with the Bank of China Hainan Branch in 2001 to partially offset the risks resulting from fluctuations between US dollars and Japanese Yen. The swap contract will not expire until 20 June 2008.

Our other income and gains increased significantly from RMB0.9 million for the three months ended 31 March 2005 to RMB7.1 million in the three months ended 31 March 2006, mainly because our Company recorded a fair value gain on the swap of RMB5.8 million in the three months ended 31 March 2006, while we had no such gain in the three months ended 31 March 2005.

Excess over the cost of a business combination

Due to the Acquisition, we recorded RMB577.6 million for the three months ended 31 March 2006 as excess over the cost of a business combination, which represents the excess of our interest in the net fair value of Tianye Chemical's identifiable assets, liabilities and contingent liabilities over the cost of the Acquisition. We recorded nil excess over the cost of a business combination for the three months ended 31 March 2005.

Selling and distribution costs

Our selling and distribution costs increased by 89.5% from RMB1.9 million for the three months ended 31 March 2005 to RMB3.6 million for the three months ended 31 March 2006, mainly due to the addition of Tianye Chemical's selling and distribution costs for the three months ended 31 March 2006. Without considering Tianye Chemical's selling and distribution costs in the period, which amounted to RMB1.1 million, our selling and distribution costs for the three months ended 31 March 2006 were generally at a similar level as for the three months ended 31 March 2005.

Administrative expenses

Our administrative expenses increased by 143.1% from RMB17.4 million for the three months ended 31 March 2005 to RMB42.3 million for the three months ended 31 March 2006. This increase was due to (i) the addition of Tianye Chemical's administrative costs in the same period amounting to RMB10.6 million; (ii) the consolidation of our newly established subsidiary, Hainan Basuo, in 2005 which contributed RMB5.6 million to our administrative expenses for the three months ended 31 March 2006 mainly consisting of salaries of its employees; and (iii) the establishment of new departments which are responsible for business development, procurement and internal audit.

Other expenses

Our other expenses decreased by 97.8% from RMB37.0 million for the three months ended 31 March 2005 to RMB0.8 million for the three months ended 31 March 2006 mainly because we recorded a fair value loss on the swap of RMB30.3 million in the three months ended 31 March 2005, while we did not record such loss for the three months ended 31 March 2006.

Finance revenue

Our finance revenue increased by 94.4% from RMB3.6 million for the three months ended 31 March 2005 to RMB7.0 million for the three months ended 31 March 2006. The increase in finance revenue was due in part to the consolidation of Tianye Chemical for the three month period ended 31 March 2006 whereby Tianye Chemical contributed finance revenue amounting to RMB2.4 million. The increase was also because we and Tianye Chemical maintained a higher level of average bank deposits for the three months ended 31 March 2006 than for the three months ended 31 March 2005 due to the net profit we and Tianye Chemical generated for the nine months from April to December of 2005.

Finance costs

Our finance costs increased by 161.0% from RMB4.1 million for the three months ended 31 March 2005 to RMB10.7 million for the three months ended 31 March 2006. The increase in finance costs was primarily because we obtained entrusted loans in the amount of RMB1.4 billion from CNOOC in late February and early March 2006, which are subject to an effective interest rate charge of 5.22% per annum.

Exchange gain/(loss), net

We incurred a foreign exchange loss of RMB6.2 million for the three months ended 31 March 2006 primarily due to the exchange loss arising from the purchase of Japanese Yen to repay parts of the Japanese Yen loan, and recorded a foreign exchange gain of RMB41.9 million for the three months ended 31 March 2005 due primarily to the 3.1% depreciation of Japanese Yen against Renminbi from 31 December 2004 to 31 March 2005.

Share of profits of associates

Share of profits of associates for the three months ended 31 March 2006 amounted to RMB0.5 million, which represented a slight increase from our share of profits of associates of RMB0.4 million for the three months ended 31 March 2005.

Income tax expense

Our income tax expense increased by RMB14.5 million, or 453.1%, from RMB3.2 million for the three months ended 31 March 2005 to RMB17.7 million for the three months ended 31 March 2006. Our effective income tax rate increased from 1.6% for the three months ended 31 March 2005 to 2.3% for the three months ended 31 March 2006. This increase was due primarily to the termination of the exempted corporate income tax rate period of our Company with respect to the operation of Fudao Phase II. Profit before tax from Fudao Phase II was subject to 7.5% corporate income tax in 2006, compared to 0.0% in 2005, which increased our income tax expense by RMB7.7 million.

Profit for the period

As a result of the foregoing factors, our profit for the period increased by 293.9%, or RMB566.7 million, from RMB192.8 million for the three months ended 31 March 2005 to RMB759.5 million for the three months ended 31 March 2006.

2005 Compared with 2004

Revenue

Our revenue increased by 17.0% from RMB2,027.3 million in 2004 to RMB2,371.0 million in 2005, due primarily to increased selling prices of granular urea products. In 2004 and 2005, approximately 96.8% and 95.3%, respectively, of our total revenue were from the production and sale of fertilizer products. The effect of the increase in selling prices was partly offset by the decrease in the sales volume of granular urea products primarily due to a slight year-on-year decrease in production volume in 2005. In addition, the services provided by Port of Basuo since 2005 also contributed RMB38.8 million to our revenue for 2005.

Total sales volumes of our granular urea products decreased slightly by 1.1% from 1,379,906 tonnes in 2004 to 1,364,607 tonnes in 2005, due primarily to the reduction in production at Fudao Phase I by 83,007 tonnes of urea products. In 2005, Typhoon Damrey hit the South China Sea area where Yacheng 13-1 Offshore Gasfield, which supplies natural gas to Fudao Phase I, is located. The typhoon did not affect Dongfeng 1-1 Offshore Gasfield, which supplies natural gas to Fudao Phase II, as it is located some 350 kilometers from Yacheng 13-1. The severe weather resulted in the suspension of natural gas and power supplies and unscheduled maintenance at Fudao Phase I, impacting its production. Although the typhoon did not result in any material disruption to the supply of natural gas from the Dongfeng 1-1 Offshore Gasfield, it affected our electricity supplier, China South Power Grid Co., Ltd., which resulted in suspension of power supplies at Fudao Phase II and impacting our production. The decrease in production volume at Fudao Phase I was partially offset by the increase in production volume at Fudao Phase II of 31,081 tonnes of urea from 2004 to 2005.

The average selling prices of the granular urea sold by us in the domestic market increased by 11.8% from RMB1,476 per tonne in 2004 to RMB1,650 per tonne in 2005. The average selling price of granular urea sold by us to overseas customers also increased 21.8% from RMB1,666 per tonne in 2004 to RMB2,030 per tonne in 2005. Increases in average selling prices were generally caused by the increased demand due to the PRC Government's policy of encouraging the use of fertilizers and the increase in prices of natural gas as a key raw material of urea both in China and elsewhere in the world. In addition, since 2003, a number of international nitrogenous fertilizer producers suspended or ceased production due to significantly increased natural gas prices, reducing the supply of urea worldwide. The price of urea products in the international markets therefore experienced significant increases. As a result, Chinese nitrogenous fertilizer producers, including us, tended to export more urea products than they previously did and at higher selling prices. Increased export sales and decreased domestic supply of urea products also drove the domestic selling prices of urea to increase in China within applicable Government pricing limits. The average selling prices of granular urea sold overseas increased in 2005; however the export volumes of granular urea decreased from 2004 to 2005 due to the PRC Government's change of policies in respect of VAT and seasonal tariff for exportation of urea. As a result, our revenue from export sales of granular urea decreased from RMB792.1 million in 2004 to RMB350.4 million in 2005.

In addition, since 1 July 2005, the PRC Government implemented a VAT exemption policy towards sales of urea products. Under the IFRS, output VAT exemption is accounted for as revenue in our fertilizer operations. Thus, our revenue increased by RMB133.1 million from 2004 to 2005 due to the related VAT benefits we enjoyed in 2005.

Cost of sales

Our cost of sales increased by 18.1% from RMB1,095.0 million in 2004 to RMB1,293.1 million in 2005. Our cost of sales was 54.5% of revenue in 2005 compared to 54.0% in 2004. Increases in our cost of sales from 2004 to 2005 were mainly because of the export tariff that we, as well as other fertilizer exporters, were subject to since 1 January 2005. In addition, since 1 July 2005, the PRC Government implemented a VAT exemption policy towards urea products sold in Mainland China. Under the IFRS, input VAT already paid for raw materials is recorded as cost of sales. Our cost of sales in 2005 increased by RMB49.8 million and RMB39.3 million due to the payment of export tariff and record of input VAT, respectively. The increases in the cost of sales from 2004 to 2005 were also attributable to the increases in the cost of natural gas, which is our primary raw material for the production at Fudao Phase I and Fudao Phase II. In 2004 and 2005, we purchased natural gas from Fuel & Chemical Corporation of Hainan, which sources natural gas from our affiliate, CNOOC Limited, for production at Fudao Phase I. The average price, consisting of the base price and transportation costs, of natural gas we purchased from Fuel & Chemical Corporation of Hainan increased slightly from 2004 to 2005. For production at Fudao Phase II, we purchased natural gas through CNOOC Limited. The average base price of natural gas we purchased from CNOOC Limited increased slightly.

We consumed 371.6 million m^3 of natural gas for production at Fudao Phase I in 2005 compared to 418.4 million m^3 of natural gas in 2004. In addition, we consumed 862.2 million m^3 of natural gas for production at Fudao Phase II in 2005 compared to 789.6 million m^3 of natural gas in 2004. Production volume of Fudao Phase I decreased from 618,888 tonnes in 2004 to 535,881 tonnes in 2005, while production volume of Fudao Phase II increased from 794,051 tonnes in 2004 to 825,132 tonnes in 2005.

We incurred depreciation costs of RMB247.5 million and RMB251.0 million in 2004 and 2005, respectively, for our production facilities, which was recorded in the cost of sales.

Gross profit

As a result of the foregoing, our gross profit increased by 15.6% from RMB932.3 million in 2004 to RMB1,077.9 million in 2005. Our gross profit margin slightly decreased to 45.5% in 2005 from 46.0% in 2004.

Other income and gains

Our other income and gains decreased significantly from RMB40.7 million in 2004 to RMB1.7 million in 2005, mainly because our Company recorded a fair value gain on the swap of RMB37.3 million in 2004, while we recorded a fair value loss of RMB67.9 million in 2005, which was accounted for as other expenses.

Selling and distribution costs

Our selling and distribution costs decreased by 50.5% from RMB31.1 million in 2004 to RMB15.4 million in 2005. The decrease in selling and distribution costs was due primarily to a decrease in export volumes of our urea products and related port charges that were borne by us. Unlike domestic sales that are on an ex-factory basis so that our customers bear all transportation costs, our export sales are on an FOB basis so that we are responsible for the ground transportation expenses and port charges. Decreases in export sales will therefore reduce the relevant transportation costs and port charges incurred by us. In 2004 and 2005, we exported approximately 541,144 tonnes and 178,380 tonnes of granular urea products to overseas customers, respectively.

Administrative expenses

Our administrative expenses increased by 70.6% from RMB76.6 million in 2004 to RMB130.7 million in 2005. This increase was primarily a result of (i) the establishment of new departments which are responsible for business development, procurement and internal audit, (ii) the consolidation of our newly established subsidiary, Hainan Basuo, in 2005 which contributed RMB13.2 million to our administrative expenses in 2005 mainly consisting of salaries of its employees, and (iii) increases in staff costs of administrative personnel excluding Hainan Basuo, amounting to RMB17.4 million.

Other expenses

Other expenses of our Company increased by 258.0% from RMB28.8 million in 2004 to RMB103.1 million in 2005. Increases of other expenses were primarily caused by a RMB67.9 million fair value loss on the swap in 2005. In 2004, we recorded a fair value gain of RMB37.3 million on the swap, which we recorded as other income and gains.

Finance revenue

Our finance revenue increased by 106.8% from RMB11.8 million in 2004 to RMB24.4 million in 2005, due to the increase in interest income from bank deposits.

Finance costs

Our finance costs increased slightly from RMB15.0 million in 2004 to RMB15.5 million in 2005, due primarily to the increase in interest on bank and other borrowings.

Exchange gain/(loss), net

As of 31 December 2004 and 2005, we had outstanding Japanese Yen denominated loans of approximately JPY17.0 billion and JPY15.6 billion, respectively, equivalent to RMB1,356.5 million and RMB1,070.5 million, respectively. We incurred a foreign exchange loss of RMB40.0 million in 2004 primarily due to the 3.2% appreciation of Japanese Yen against Renminbi from 31 December 2003 to 31 December 2004, and recorded a foreign exchange gain of RMB189.5 million in 2005 due primarily to the 13.8% depreciation of Japanese Yen against Renminbi from 31 December 2004 to 31 December 2005.

Share of profits of associates

Share of profits of associates in 2005 amounted to RMB1.9 million, which represented a 18.8% increase from our share of profits of associates of RMB1.6 million in 2004. The increase in share of profits of associates was primarily due to the year-on-year increase in net profits recorded by Guangxi Fudao AMP, a company in which we owned an effective 26.11% equity interest during the Track Record Period.

Income tax expense

Our income tax expense increased by 76.6% from RMB26.9 million in 2004 to RMB47.5 million in 2005. Our effective income tax rate increased from 3.4% in 2004 to 4.6% in 2005. This increase was due primarily to the termination of the reduced corporate income tax rate period of our principal subsidiary and operator of Fudao Phase I, CNOOC Fudao. As a result, profit before tax from Fudao Phase I was subject to 15% corporate income tax in 2005 compared to 7.5% in 2004. CNOOC Fudao recorded a year-on-year increase in tax expense of RMB19.7 million in 2005.

Profit for the year

As a result of the foregoing factors, our profit for the year increased by 28.0%, or RMB215.2 million, from RMB768.0 million in 2004 to RMB983.2 million in 2005.

2004 Compared with 2003

Revenue

Our revenue increased by 174.6% from RMB738.2 million in 2003 to RMB2,027.3 million in 2004. This increase was due primarily to the commencement of mass production at Fudao Phase II as well as increases in average selling prices of our granular urea products and increases in exports sales. In 2003 and 2004, approximately 96.2% and 96.8%, respectively, of our total revenue were from the production and sale of fertilizer products.

Total sales volumes of our granular urea products increased by 141.1% from approximately 572,276 tonnes in 2003 to 1,379,906 tonnes in 2004, among which 243,713 tonnes and 541,144 tonnes were export sales to overseas customers in 2003 and 2004, respectively. We substantially completed the construction and trial operation of Fudao Phase II by the end of 2003 and started mass production in January 2004. In 2004, we produced a total of 794,051 tonnes of granular urea at Fudao Phase II.

The average selling prices of granular urea products sold by our Company in the domestic market increased by 14.7% from RMB1,287 per tonne in 2003 to RMB1,476 per tonne in 2004. The average selling price of granular urea products sold to overseas customers also increased by 23.2% from RMB1,352 per tonne in 2003 to RMB1,666 per tonne in 2004. Increases in average selling prices were generally caused by the increased prices of natural gas as a key raw material of urea both in China and elsewhere in the world.

Cost of sales

Our cost of sales increased by 129.8% from RMB476.5 million in 2003 to RMB1,095.0 million in 2004. Our cost of sales increased primarily as a result of increased sales volume and natural gas prices in 2004 compared to 2003. However, the percentage of our cost of sales over revenue decreased from 64.5% in 2003 to 54.0% in 2004. The decrease was primarily due to the commencement of production at Fudao Phase II, a new facility which is more efficient than Fudao Phase I in terms of energy consumption.

We consumed 418.4 million m^3 of natural gas for the production of Fudao Phase I in 2004 compared to 409.9 million m^3 in 2003. Production volume of Fudao Phase I increased from 602,373 tonnes in 2003 to 618,888 tonnes in 2004.

We consumed 789.6 million m^3 of natural gas for the production of Fudao Phase II in 2004, whereas all costs in connection with the natural gas utilized by Fudao Phase II prior to its mass production in January 2004 were capitalized.

We incurred depreciation costs of RMB115.0 million and RMB247.5 million in 2003 and 2004, respectively, for our production facilities, which was recorded in the cost of sales.

Gross profit

As a result of the foregoing, our gross profit increased significantly from RMB261.7 million in 2003 to RMB932.3 million in 2004. Our gross profit margin was 46.0% in 2004 compared to 35.5% in 2003. The increase in gross profit margin was due primarily to higher selling prices and the proportional reductions in costs of sales as a result of the synergies between Fudao Phase I and Fudao Phase II. Fudao Phase II shares part of its manufacturing, maintenance and environmental protection equipment and staff with Fudao Phase I, and this enabled us to produce our products at an average cost lower than that during the time prior to Fudao Phase II's commencement of mass production in 2004.

Other income and gains

Our other income and gains decreased by 48.7% from RMB79.4 million in 2003 to RMB40.7 million in 2004. The decrease was primarily attributable to the fact that we received VAT refund of RMB19.8 million in 2003 in respect of VAT paid in 2002 but did not receive any refund in 2004 due to the PRC Government's suspension of VAT refunds in 2003. In addition, our other income and gains also decreased as a result of the decreases of fair value gain on the swap from RMB47.2 million to RMB37.3 million in 2004.

Selling and distribution costs

Our selling and distribution costs increased by 63.7% from RMB19.0 million in 2003 to RMB31.1 million in 2004. The increase in selling and distribution costs was due primarily to an increase in export volumes which resulted in related transportation expenses and port charges that were borne by us and applicable to export sales only. In 2004, we exported approximately 541,144 tonnes of granular urea products to overseas customers compared to only 243,713 tonnes of granular urea products exported in 2003 due to a 23.2% increase in sales prices of urea in the overseas market in 2004 compared to 2003. However, from 1 January 2004 to 15 March 2004, the VAT refund for export sales was reduced from 13% to 11% and further reduced to a refund of 50% of the VAT paid from 16 March 2004.

Administrative expenses

Our administrative expenses increased by 35.6% from RMB56.5 million in 2003 to RMB76.6 million in 2004. This increase of RMB20.1 million was primarily due to (i) expenses for information technology; and (ii) increased expenses for employee training and salaries resulting from the commencement of operation of Fudao Phase II.

Other expenses

Other expenses of our Company increased by 21.0% from RMB23.8 million in 2003 to RMB28.8 million in 2004. Increases in other expenses were primarily caused by realized losses on the swap.

Finance revenue

Our finance revenue increased by 210.5% from RMB3.8 million in 2003 to RMB11.8 million in 2004. Our average bank deposits increased in 2004 compared with 2003 mainly because we generated more cash than in 2003 as a result of the commencement of mass production at Fudao Phase II in January 2004. As such, more interest income was earned.

Finance costs

Our finance costs increased by 94.8% from RMB7.7 million in 2003 to RMB15.0 million in 2004, due primarily to the increase of interest on bank loans. Part of the interest expenses relating to the construction of Fudao Phase II was capitalized in 2003, whereas interest was reflected as expense in 2004 as construction of Fudao Phase II was substantially completed by the end of 2003.

Exchange loss, net

As of 31 December 2003 and 2004, we had outstanding bank loans of JPY14.6 billion and JPY17.0 billion, respectively. We recorded foreign exchange losses of RMB56.1 million in 2003 primarily due to the 11.9% appreciation of Japanese Yen against Renminbi from 31 December 2002 to 31 December 2003, and also recorded foreign exchange losses of RMB40.0 million in 2004 primarily due to the 3.2% appreciation of Japanese Yen against Renminbi from 31 December 2003 to 31 December 2004.

We also capitalized an exchange loss of RMB41.9 million in 2003 that we recorded as an adjustment to interest cost qualifying for capitalization under the relevant requirements of IFRS.

Share of profits of associates

Share of profits of associates for 2004 was RMB1.6 million, an increase of 77.8% compared to RMB0.9 million in 2003 mainly relating to our share of the increase in net profit generated by our associate company, Guangxi Fudao AMP in 2004.

Income tax expense

Our income tax expense increased by 56.4% from RMB17.2 million in 2003 to RMB26.9 million in 2004. However, our effective income tax rate decreased from 9.4% in 2003 to 3.4% in 2004. The decrease in the effective income tax rate was due primarily to mass production and sales from Fudao Phase II, which enabled CNOOC Chemical to begin enjoying a two-year income tax exemption followed by a three-year 50% income tax reduction from 2004. Increases in our income tax expense in 2004 from 2003 were due primarily to the increased profit before tax. The effective corporate income tax rate for CNOOC Fudao Co., Limited, the operator of Fudao Phase I, remained as 7.5% in 2003 and 2004.

Profit for the year

As a result of the foregoing factors, our profit for the year increased by 364.0%, or RMB602.5 million, from RMB165.5 million to RMB768.0 million.

Liquidity and Capital Resources

To date we have funded our operations principally from cash generated from our operations, capital contributions from our shareholders and bank borrowings. Any significant decrease in demand for, or pricing of, our products or a significant decrease in the availability of bank loans may adversely impact our liquidity.

Our current assets divided by current liabilities, or current ratio, was 1.9, 2.7, 2.5 and 0.5 as of 31 December 2003, 2004 and 2005 and 31 March 2006, respectively. Our current assets after subtraction of inventories divided by current liabilities, or quick ratio, was 1.6, 2.5, 2.3 and 0.5 as of 31 December 2003, 2004 and 2005 and 31 March 2006, respectively. Decreases in construction payables for Fudao Phase II and cash generated from operations caused the increase in both current ratio and quick ratio in 2004. Both current ratio and quick ratio decreased in 2005 as a result of the investment in Hainan Basuo. The decrease in both current ratio and quick ratio in the three months ended 31 March 2006 was a result of the RMB1.2 billion dividends payable and was also because we repaid approximately RMB690.0 million long-term Japanese Yen denominated bank loans with cash of approximately RMB190.0 million and short-term unsecured entrusted loans of RMB500.0 million from CNOOC. Both current ratio and quick ratio decreased in the first three months of 2006 also because of the Acquisition and the recognition of the 2005 Special Dividend of RMB1,210.8 million as a current liability.

As of 31 March 2006, our current assets, amounting to RMB2,218.2 million, mainly comprised RMB1,766.0 million cash and cash equivalents and RMB244.6 million inventories. As of 31 March 2006, we had cash and bank balances excluding pledged bank deposits of RMB1,327.8 million. Among our cash and cash equivalents, RMB408.2 million were non-pledged time deposits with original maturity of three months or more as of 31 March 2006. Our inventories as of 31 March 2006 consisted of RMB183.9 million of raw materials, RMB44.0 million of work in progress and RMB16.7 million of finished goods.

As of 31 March 2006, our current liabilities, amounting to RMB4,298.5 million, mainly comprised RMB2,691.1 million other payables and accruals, RMB1,210.8 million dividend payables and RMB261.8 million interest-bearing bank and other borrowings. Other payables and accruals as of 31 March 2006 mainly included RMB1,396.7 million payable to CNOOC, RMB488.3 million payable to the Inner Mongolia Finance Bureau, RMB113.9 million advances from customers and RMB651.9 million other payables which mainly included RMB76.1 million salary and welfare payables, RMB27.2 million payable to Hainan Development, RMB15.8 million social insurance payable, RMB139.0 million payable in relation to the construction and purchase of property, plant and equipment, RMB165.3 million port construction fee payable and RMB80.8 million payable to early retirees and staff welfare. The current portion of interest-bearing bank and other borrowings mainly consisted of (i) RMB214.9 million as unsecured bank loans denominated in Japanese Yen, US dollars and Renminbi bearing interest at rates between LIBOR plus 0.55% to 5.2%, and (ii) secured and unsecured other loans amounting to RMB46.9 million bearing interest at rates between 2.25% to 5.02%. The RMB488.3 million payable to the Inner Mongolia Finance Bureau was paid on 30 April 2006.

Cash Flow

Our primary uses of cash are to invest in additional manufacturing facilities and equipment, service our indebtedness, and fund working capital and normal recurring expenses. As of 31 March 2006, we had cash and cash equivalents of RMB1,357.8 million for the purpose of the consolidated cash flow statement. The following table sets out changes in cash flows for each of the three years ended 31 December 2003, 2004 and 2005 and the three months ended 31 March 2005 and 2006:

	Year ended 31 December			Three months ended 31 March	
	2003	**2004**	**2005**	**2005**	**2006**
			(RMB million)		
		(audited)		(unaudited)	(audited)
Cash and cash equivalents at beginning of year/period	865.5	690.5	1,111.8	1,111.8	1,719.7
Net cash inflow from operating activities	185.4	1,074.6	917.1	215.8	535.0
Net cash outflow from investing activities	(987.9)	(626.2)	(361.4)	(510.5)	(1,316.5)
Net cash inflow/(outflow) from financing activities	627.5	(27.1)	52.2	15.8	419.6
Net increase/(decrease) in cash and cash equivalents	(175.0)	421.3	607.9	(278.9)	(361.9)
Cash and cash equivalents at end of year/period	690.5	1,111.8	1,719.7	832.9	1,357.8

Cash flows from operating activities

Net cash generated from operating activities increased significantly from RMB215.8 million for the three months ended 31 March 2005 to RMB535.0 million for the three months ended 31 March 2006. The increase of RMB319.2 million was attributable to (i) an increase in operating profit before working capital changes from RMB250.1 million for the three months ended 31 March 2005 to RMB312.6 million for the three months ended 31 March 2006; and (ii) a decrease in trade and bills receivables, prepayments, deposits and other receivables amounting to RMB205.6 million for the three months ended 31 March 2006, compared to an increase in trade and bills receivables, prepayments, deposits and other receivables amounting to RMB2.9 million for the three months ended 31 March 2005 mainly due to significantly reduced export sales which generally generate a substantial amount of accounts and trades receivable based on the terms of sales.

Net cash generated from operating activities decreased by 14.7% from RMB1,074.6 million for the year ended 31 December 2004 to RMB917.1 million for the year ended 31 December 2005. The decrease of RMB157.5 million was attributable to (i) an increase in trade and bills receivables, prepayments, deposits and other receivables amounting to RMB150.8 million for the year ended 31 December 2005, compared to a decrease in trade and bills receivables, prepayments, deposits and other receivables amounting to RMB70.4 million for the year ended 31 December 2004 due to the fact that more export and domestic sales in 2005 were incurred in December 2005 compared to the same period in 2004; (ii) an increase in inventories of RMB21.3 million for the year ended 31 December 2005 from a decrease in inventories of RMB11.2 million for the year ended 31 December 2004, due to the fact that, in 2005, we procured and kept spare parts for scheduled maintenance but, in 2004, our sales volume exceeded production volume. The decreases in cash inflow from operating activities were partly offset by an increase in operating profit before working capital changes from RMB1,059.5 million for 2004 to RMB1,163.8 million for 2005, and a decrease in trade payables, other payables and accruals amounting to RMB2.8 million for the year ended 31 December 2005, compared to a decrease amounting to RMB42.2 million for the year ended 31 December 2004. In 2004, a portion of the fees payable to the contractors and equipment providers of Fudao Phase II remained unsettled, while in 2005, we repaid all unsettled amounts.

Net cash generated from operating activities increased by 479.6% from RMB185.4 million for the year ended 31 December 2003 to RMB1,074.6 million for the year ended 31 December 2004. The increase of RMB889.2 million was attributable to: (i) a significant increase in operating profit before working capital changes from RMB318.3 million to RMB1,059.5 million as a result of Fudao Phase II's mass production; (ii) a decrease in trade and bills receivables, prepayments, deposits and other receivables amounting to RMB70.4 million for the year ended 31 December 2004, compared to an increase amounting to RMB34.5 million for the year ended 31 December 2003 due to settlement of bills received from our customers in 2004 and reduction of prepayments for the projects under construction; and (iii) a decrease in inventories of RMB11.2 million for the year ended 31 December 2004, compared to an increase of RMB16.3 million for the year ended 31 December 2003 because of strong market demand for fertilizers in 2004 resulting in a decrease in inventories. Increases in net cash generated from operating activities were partially offset by the decrease in trade payables, other payables and accruals of RMB42.2 million for the year ended 31 December 2004 due to the fact that payments of construction payables relating to the construction of Fudao Phase II were made in 2004.

Cash flows from investing activities

Net cash used in investing activities increased by 157.9% from RMB510.5 million for the three months ended 31 March 2005 to RMB1,316.5 million for the three months ended 31 March 2006. The increase of RMB806.0 million was mainly attributable to the consideration paid for the Acquisition amounting to RMB892.2 million, net of the cash and cash equivalents acquired and the purchases of property, plant and equipment of RMB297.4 million. The increases of net cash used in investing activities for the three months ended 31 March 2006 compared to the three months ended 31 March 2005 were partly offset by an increase of RMB78.2 million in non-pledged time deposits with original maturity of three months or more when acquired for the three months ended 31 March 2006, compared to an increase of RMB494.0 million in non-pledged time deposits with original maturity of three months or more when acquired for the three months ended 31 March 2005.

Net cash used in investing activities decreased by 42.3% from RMB626.2 million for the year ended 31 December 2004 to RMB361.4 million for the year ended 31 December 2005. The decrease of RMB264.8 million was mainly attributable to a decrease of RMB92.0 million in non-pledged time deposits with original maturity of three months or more when acquired for the year ended 31 December 2005, compared to an increase of RMB322.0 million in non-pledged time deposits with original maturity of three months or more when acquired for the year ended 31 December 2004.

Net cash used in investing activities decreased 36.6% to RMB626.2 million for the year ended 31 December 2004 from RMB987.9 million for the year ended 31 December 2003. The decrease of RMB361.7 million was mainly attributable to RMB319.1 million used for the purchase of property, plant and equipment for the year ended 31 December 2004, compared to RMB989.5 million used for such purchases due to the completion of Fudao Phase II in 2003.

Net cash flow from financing activities

Net cash inflow for financing activities was RMB419.6 million for the three months ended 31 March 2006, compared to RMB15.8 million for the three months ended 31 March 2005. The significant increase in net cash inflow was mainly because we received unsecured entrusted loans of RMB1,410.0 million from CNOOC, partially offset by (i) the repayment of RMB757.4 million bank and other borrowings to partially settle the Japanese Yen denominated loan in order to reduce the Company's exposure to future Japanese Yen fluctuations, and (ii) the repayment by Tianye Chemical of RMB416.6 million loans to the Inner Mongolia Finance Bureau for the three months ended 31 March 2006.

Net cash inflow from financing activities was RMB52.2 million for the year ended 31 December 2005, compared to RMB27.1 million of cash outflow for the year ended 31 December 2004 and RMB627.5 million of cash inflow for the year ended 31 December 2003. The changes were mainly because (i) we received RMB517.7 million as paid-up capital from CNOOC and borrowed RMB373.4 million from domestic banks to finance the construction of Fudao Phase II in 2003, (ii) we received RMB151.6 million as paid-up capital from CNOOC and borrowed RMB153.0 million to finance the establishment of CNOOC Jiantao in 2004, (iii) we received RMB150.3 million as paid-up capital from CNOOC and borrowed RMB154.1 million to finance the establishment of Hainan Basuo in 2005. The cash inflows from financing activities were partially offset by the cash outflows due to dividend and interest payment, repayment of bank and other borrowings amounting to RMB263.7 million, RMB331.7 million and RMB264.1 million in 2003, 2004 and 2005, respectively.

Working Capital

We have historically met our working capital needs through cash generated by operations, advances from shareholders and long- and short-term debts. We utilize deposits we receive from our customers to finance part of our working capital requirements. These deposits amounted to RMB113.9 million as of 31 March 2006. On the other hand, we make prepayments to suppliers of utilities and fixed assets and construction materials which form part of our working capital requirements. Such prepayments amounted to RMB49.6 million as of 31 March 2006.

As of 31 July 2006, we had credit facilities in the aggregate amount of approximately RMB1,401.0 million made available to us by commercial banks and CNOOC Finance. On 11 September 2006, our credit facilities were reduced by RMB540.0 million short-term borrowings as described in "—Indebtedness" below.

Trade Receivables, Inventory and Trade Payables Turnover

The following table sets forth the turnover days of our trade receivables, inventories and trade payables for the periods indicated:

	Year ended 31 December			Three months ended 31 March
	2003	2004	2005	2006
			(days)	
Turnover days of trade receivables[(1)]	20.6	12.3	19.0	13.4
Turnover days of inventories[(2)]	109.0	48.3	42.5	40.8
Turnover days of trade payables[(3)]	59.9	21.0	15.0	12.0

(1) Turnover days of trade receivables is derived by dividing the arithmetic mean of the opening and closing balances of trade receivables for the relevant period by turnover and multiplying by 365 days or 90 days, as the case may be.

(2) Turnover days of inventories is derived by dividing the arithmetic mean of the opening and closing balances of inventory for the relevant period by cost of sales multiplying 365 days or 90 days, as the case may be.

(3) Turnover days of trade payables is derived by dividing the arithmetic mean of opening and closing balances of trade payables, for the relevant period by cost of sales and multiplying by 365 days or 90 days, as the case may be.

Due to strong demand for our products and for the purpose of managing credit risks, we normally require payment in advance from most of our customers. In limited cases, we grant certain domestic customers presenting credible commercial acceptance drafts credit terms of up to 90 days. In addition, we deliver our urea products to overseas customers based on letters of credit. We seek to maintain strict control over our trade receivables and have a credit control policy to minimize the credit risk. We generally write off the full amount of our debts for which collection is no longer possible, taking into consideration certain factors such as the financial condition of the customers and the age of such debts. Changes of the turnover rates and days of trade receivables during the Track Record Period were mainly due to the fact that, in certain years such as 2003 and 2005, more urea export sales on a letter-of-credit basis occurred toward the end of the respective year and were treated as trade receivables at the year end of such years.

Our inventory turnover rate improved significantly from 2003 to 2004 due to market reasons, and further improved in 2005 through enhancement of our inventory management system.

The change in the trade payable turnover rate from 2003 to 2004 is due to the fact that certain amounts of purchases were capitalized during the trial operation period of Fudao Phase II in 2003. In addition, our trade payable turnover rate further improved as a result of our strict compliance with payment terms.

Capital Expenditures

Our principal requirements for capital expenditures are in relation to the expansion of our production facilities, major maintenance, modernization of existing plants and machinery for urea production and construction of plants for new products such as methanol and methanol derivatives, polyoxymethylene, compound fertilizers and carbon dioxide and related products, as well as new port facilities at Port of Basuo. Our capital expenditures with respect to the purchase of property, plant and equipment were RMB1,294.5 million, RMB292.3 million, RMB461.8 million and RMB340.4 million for the years ended 31 December 2003, 2004 and 2005 and the three months ended 31 March 2006, respectively. Capital expenditures during these periods were primarily related to property, plant and equipment and intangible assets.

As part of our future growth strategy, we estimate that our capital expenditures will be approximately RMB2,006.4 million, RMB2,210.0 million and RMB2,550.0 million for 2006, 2007 and 2008, respectively. The following table sets forth our capital expenditures during the Track Record Period as well as the current estimate of our capital expenditures for 2006, 2007 and 2008, primarily in relation to mineral fertilizers production and chemicals production and others:

	2003	2004	2005	2006E	2007E	2008E
			(RMB in millions)			
Fertilizers[1]	1,271.8	230.9	79.6	1,036.3	740.0[3]	700.0[3]
Chemicals and others[2]	22.7	61.4	382.2	970.1	1,470.0	1,850.0
Total	1,294.5	292.3	461.8	2,006.4	2,210.0	2,550.0

(1) Includes expansion of production facilities and assessment of new products, such as compound fertilizers.

(2) Includes construction of new plant and new product assessment for methanol and methanol derivatives, polyoxymethylene, carbon dioxide and other related products.

(3) Includes RMB600.0 million budgeted for acquisitions in each of the years 2007 and 2008. Such expenditure will not be funded from the proceeds of the Global Offering and so far no specific targets for acquisition have been identified.

We anticipate that the capital expenditures described above will be financed by cash generated from our operations, bank borrowings and the net proceeds from the Global Offering. The estimated amount of expenditures may vary from the actual amount for a variety of reasons, including changes in market conditions, competition and other factors.

As of 31 March 2006, we incurred RMB1,310.1 million for our capital expenditure of 2006 as RMB964.6 million and RMB5.1 million for the acquisition of Tianye Chemical and minority interests of Hainan CNOOC Complex Fertilizer Co., Ltd., respectively, and RMB340.4 million for the purchase of property, plant and equipment and additions of prepaid land lease payments. We plan to meet the remaining RMB696.3 million of approved capital expenditure using internally generated cash from our operations, external borrowings and the proceeds from the Global Offering.

Our current plan with respect to future capital expenditures is subject to change based on the evolution of our business plan, including potential acquisitions, the progress of our capital projects, prevailing market conditions and our future outlook. There is no guarantee that any of the planned capital expenditures outlined above will proceed as planned. As we continue to expand, we may incur additional capital expenditures. In the future, we may consider additional debt or equity financing, depending on market conditions, our financial performance and other relevant factors. We cannot assure you that we will be able to raise additional capital, should that become necessary, on terms acceptable to us or at all. Other than as required by law, we do not undertake any obligation to publish updates of our capital expenditure plans. See "Forward-looking statements".

Indebtedness

Borrowings

Our consolidated interest-bearing borrowings as of 31 December 2003, 2004 and 2005, 31 March 2006 and 31 July 2006 for the purpose of calculating the indebtedness of our Company, were as follows:

	As of 31 December			As of 31 March	As of
	2003	2004	2005	2006	31 July 2006
			(RMB million)		
	(audited)	(audited)	(audited)	(audited)	(unaudited)
Secured bank loans	10.6	9.0	2.3	—	—
Unsecured bank loans	1,553.0	1,616.1	1,300.2	679.0	2,016.7
Other loans	6.5	5.3	63.3	67.9	37.4
Total	1,570.1	1,630.4	1,365.8	746.9	2,054.1

The above interest-bearing borrowings as of 31 December 2003, 2004 and 2005 and as of 31 March 2006 and 31 July 2006 bore interest at effective rates ranging from LIBOR plus 0.55% to 6.6% per annum.

The maturity profile of interest-bearing borrowings of our Company as of 31 December 2003, 2004 and 2005, 31 March 2006 and 31 July 2006 was as follows:

	As of 31 December			As of 31 March	As of
	2003	2004	2005	2006	31 July 2006
			(RMB million)		
	(audited)	(audited)	(audited)	(audited)	(unaudited)
Within one year or on demand	148.2	318.6	335.4	261.8	1,590.9
In the second year	333.4	278.1	185.1	209.5	202.5
In the third to fifth years, inclusive	540.9	518.7	539.5	185.7	142.2
Beyond five years	547.6	515.0	305.8	89.9	118.5
Total	1,570.1	1,630.4	1,365.8	746.9	2,054.1

Our gearing ratio was 38.0%, 33.7%, 22.2%, 8.6% and 23.5% as of 31 December 2003, 2004 and 2005, 31 March 2006 and 31 July 2006, respectively, for the purposes of calculating our indebtedness. Gearing ratio is derived by dividing total interest-bearing bank and other borrowings by total assets.

As of 31 March 2006, RMB381.2 million of our total interest-bearing bank and other borrowings were guaranteed by CNOOC and RMB69.8 million were guaranteed by other subsidiaries of CNOOC. All the guarantees provided by CNOOC and its other subsidiaries were released in full in June 2006.

A majority of our bank loans are denominated in Renminbi, Japanese Yen and U.S. dollars. We secured a Japanese Yen Loan because it was one of very few foreign currencies approved by the PRC Government for foreign currency loans at the time of borrowing and readily available. As of 31 December 2003, 2004 and 2005 and 31 March 2006 and 31 July 2006, the balance of our loans in Japanese Yen borrowed from Bank of China were JPY14.6 billion, JPY17.0 billion, JPY15.6 billion, JPY5.6 billion and JPY4.5 billion, respectively, with the interest rate of LIBOR plus 0.6% per annum. In addition, we had bank loans denominated in U.S. dollars equivalent to approximately RMB370.6 million, RMB246.6 million, RMB218.6 million, RMB286.6 million and RMB267.1 million, respectively, as of 31 December 2003, 2004 and 2005, 31 March 2006 and 31 July 2006, with interest rates ranging from LIBOR plus 0.55 to LIBOR plus 0.65% per annum.

In February and March 2006, we prepaid a Japanese Yen denominated loan in an aggregate amount of approximately JPY10.0 billion in anticipation of the potential appreciation of the Japanese Yen against the Renminbi. As such, after the prepayment and as of 31 March 2006, we had an outstanding Japanese Yen denominated loan of approximately JPY5.6 billion, which will be repaid in accordance with its repayment schedule with the final repayment date on 20 June 2008.

For the period ended 31 March 2006, we received principal and interest in Japanese Yen and paid principal and interest in U.S. dollars under the swap. The notional amount of the swap is approximately JPY15.6 billion or U.S.$136.4 million as of 31 March 2006 and will be amortized to JPY11.1 billion or U.S.$97.4 million in the last coupon period before it matures on 20 June 2008.

The interest rate applied is six month LIBOR plus 0.6% per annum for Japanese Yen and a fixed rate of 3.93% per annum for U.S. dollars, respectively.

As of 31 December 2005 and 31 March 2006, included in the above secured bank loans of our Company, were short term loans of RMB57.0 million and RMB43.7 million, respectively, obtained from discounting the commercial acceptance drafts with recourse. The bills discounting service is provided by CNOOC Finance with similar terms offered by other financial institutions. All the commercial acceptance bills with recourse as of 31 March 2006 were settled in full before the Latest Practicable Date.

Our Company entered a settlement loan agreement with CNOOC Finance on 28 July 2005. According to this agreement, if we do not have sufficient balance in our account with CNOOC Finance to pay for natural gas purchased from CNOOC Limited, CNOOC Finance provides us with a RMB300.0 million credit facility without our application. The term of a settlement loan is six months. The interest rate of such settlement loan is 10% below the PBOC base rate of six-month loans. See "Connected Transactions".

In addition, we entered into an entrustment loan agreement with CNOOC and CNOOC Finance on 22 February 2006, according to which CNOOC would lend an aggregate amount of RMB1,860.0 million through CNOOC Finance for purposes of repaying our existing loans. The term of such loan is six months starting from the date we draw down the first loan under this agreement. In February 2006, we drew down an aggregate amount of RMB1,410.0 million under this agreement, among which RMB500.0 million was used to repay Japanese Yen loans we owed to Bank of China and RMB910.0 million was lent through CNOOC Finance to Tianye Chemical to pay to the Inner Mongolia Finance Bureau as discussed in more detail below. We have repaid all the outstanding loans owed to CNOOC under the entrustment loan agreement before the Latest Practicable Date.

As of 31 March 2006 and 31 July 2006, CNOOC Jiantao had been granted with total banking facilities and loan facilities made available by CNOOC Finance of approximately RMB975.0 million and RMB907.0 million, respectively. Out of the total credit facilities granted, amounts totaling approximately RMB398.9 million and RMB555.5 million respectively have been utilized by CNOOC Jiantao as of 31 March 2006 and 31 July 2006. As of 31 July 2006, excluding CNOOC Jiantao, we had RMB1,190.0 million banking facilities available for future use.

As of 31 March 2006, we had long term liabilities primarily consisting of a RMB15.8 million government grant received by Hainan Basuo from the PRC Ministry of Communications to be used specifically for future renovation of the port facilities operated by Hainan Basuo.

To finance the dividend payment for the 2005 Special Dividend and the Pre-establishment Distribution, on 11 September 2006, we borrowed RMB540.0 million from commercial banks as short-term loans from our overall credit facilities at the interest rates ranging from 4.86% to 5.265%. After and due to the borrowing, our credit facilities as of 31 July 2006 were reduced by RMB540.0 million.

Other than as disclosed above, there has been no material change in our indebtedness since 31 July 2006.

Contractual Obligations

The following table sets forth the scheduled maturity profile of our material contractual obligations as of 31 March 2006.

	Payments due as of years ended 31 December		
	2006	2007 to 2010	2011 and after
	RMB	RMB (in millions)	RMB
Debt obligations[1]	261.8	395.2	89.9

(1) Represents bank loans and other borrowings.

Contingent Liabilities

We had the following contingent liabilities as of the dates indicated below:

	As of 31 December			As of 31 March	As of 31 July
	2003	2004	2005	2006	2006
	RMB	RMB	RMB (in millions)	RMB	RMB
Guarantees given to a bank in connection with banking facilities granted to and utilized by a CNOOC group company	351.3	338.1	294.0	272.0	—

Except as disclosed above, we did not have any outstanding loan capital, bank overdrafts, and liabilities under acceptances or other similar indebtedness, debentures, mortgages, charges or loans or acceptance credits or hire purchase commitments, or guarantees or other material contingent liabilities outstanding as of 31 March 2006.

The guarantees in connection with banking facilities granted to the CNOOC Group company were released in full in June 2006.

Save as disclosed in this Prospectus, we confirm that there has not been any material change in the contingent liabilities of our Company since 31 March 2006.

Capital Commitments

Our capital commitments consist of (i) contracted but not provided for and (ii) authorized but not contracted for expenditures in relation to the acquisition of property, plant and equipment. Set forth below are the aggregate amounts of our capital commitments as of 31 December 2003, 2004 and 2005 and 31 March 2006:

	31 December			31 March
	2003	2004	2005	2006
	(RMB million)			
Contracted, but not provided for:				
—Acquisition of land and buildings	—	—	50.3	41.5
—Acquisition of plant and machinery	81.8	19.2	—	8.8
Authorized, but not contracted for:				
—Acquisition of land and buildings	—	—	196.8	199.8
—Acquisition of plant and machinery	0.8	13.8	1.8	300.0
Total	82.6	33.0	248.9	550.1

Our capital expenditure with respect to the purchase of property, plant and equipment for the years ended 31 December 2003, 2004 and 2005 and the three months ended 31 March 2006 were RMB1,294.5 million, RMB292.3 million, RMB461.8 million and RMB340.4 million, respectively. In addition, we expect to expend RMB2,006.4 million as capital expenditure for the year ending 31 December 2006. See "—Liquidity and capital resources—Capital expenditures". Our capital expenditures are primarily related to the projects approved by our Board of Directors, pending contractual commitments. As a result, there are discrepancies between our capital expenditure and capital commitments in the respective periods.

Off-balance Sheet Arrangements

An off-balance sheet arrangement is any transaction, agreement or other contractual arrangement involving an unconsolidated entity under which a company has (i) made guarantees, or (ii) any obligation arising out of a material variable interest in an unconsolidated entity that provides financing, liquidity, market risk or credit risk support to our Company, or that engages in leasing, hedging, or research and development arrangements with our Company.

As of 31 March 2006, we had provided a corporate guarantee to a bank in connection with banking facilities of RMB272.0 million granted to and utilized by CNOOC Hainan Power Generation Co., Ltd., a former affiliated company of our Company. Such guarantee was assumed by us on 9 November 2001 and released in full in June 2006. Except as disclosed, as of 31 March 2006, we did not have any other material off-balance sheet arrangements with unconsolidated entities.

Quantitative and Qualitative Disclosures about Market Risk

We are exposed to various types of market risks in the ordinary course of our business, including fluctuations in interest rates and foreign exchange rates and changes in the selling prices for our main products and costs of raw materials. We manage our exposure to these and other market risks through regular operating and financial activities.

Interest Rate Risks

Our exposure to market risk for changes in interest rates relates primarily to fluctuations in interest rates on our short-term and long-term debt and our ability to borrow further funds. Higher interest rates may adversely affect our net profit.

We have not historically been exposed nor do we anticipate being exposed to material risks due to changes in interest rates denominated in RMB, although our future interest income and interest payment may fluctuate in line with changes in interest rates denominated in RMB. However, we have historically been exposed to interest rate risks in respect of our bank loans denominated in Japanese Yen. In order to mitigate such risk, we entered into the swap on 29 April 2001 in respect of approximately JPY7,789.0 million swapped into U.S. dollar loans for a period of seven years.

Foreign Exchange Risk

We generated RMB291.6 million, RMB792.1 million, RMB350.4 million and RMB0.0 million as income from export sales of our urea products for the years ended 31 December 2003, 2004 and 2005 and the three months ended 31 March 2006, respectively. We mainly receive payment in U.S. dollars for export sales. We also have a substantial amount of indebtedness denominated in foreign currencies, including the Japanese Yen and the U.S. dollar. For detailed information on our bank loans denominated in foreign currencies, see "—Indebtedness". Consequently, foreign currency fluctuations, particularly fluctuations in the U.S. dollar and the Japanese Yen against Renminbi, have affected, and will continue to affect, our results of operations.

In order to reduce our exposure to interest rate and exchange rate fluctuations from our Yen Loan, we entered into a cross currency interest rate swap contract to partially offset against future repayments of certain Japanese Yen denominated bank loans and their related interest payments. The swap contract will expire in 2008. For the period from 10 May 2001 to 20 June 2005, we paid Japanese Yen to the Bank of China Hainan branch and received U.S. dollars at the pre-determined exchange rate of JPY/U.S.$ = 124. From 21 June 2005 to 20 June 2008, we paid and will continue to pay U.S. dollars to the Bank of China Hainan branch and received and will continue to receive Japanese Yen. As of 31 March 2006, the notional amount of the swap was approximately JPY15.6 billion.

However, in February and March 2006, we prepaid the Japanese Yen Loan in an aggregate amount of approximately JPY10.0 billion to reduce our exposure to foreign exchange risks. As such, after the prepayment and as of 31 March 2006, we had an outstanding Japanese Yen Loan of approximately JPY5.6 billion. As both the Japanese Yen Loan will mature and the swap contract will expire in June 2008, the impact of the Japanese Yen exchange rate on the Japanese Yen Loan will be largely offset by the impact of the swap position.

In addition, our cash flows and revenues will be affected by the foreign exchange rate between the U.S. dollar and Renminbi. For example, to the extent that we need to convert U.S. dollars into

Renminbi for our operational needs and should the Renminbi appreciate against the U.S. dollar at that time, our cash flows would be reduced, which could materially adversely affect our business. Conversely, if we decide to convert our Renminbi into U.S. dollars to fulfill our obligations under the swap contract and the U.S. dollar appreciates against the Renminbi, the U.S. dollar equivalent of our earnings would be reduced.

Inflation and Monetary Risk

Inflation in China has not had a material impact on our results of operations in recent years. According to the National Bureau of Statistics of China, the change in the Consumer Price Index in China was 1.2%, 3.9% and 1.8% in 2003, 2004 and 2005, respectively.

Commodity Price Risk

We are also exposed to commodity price risk resulting from changes in the prices of our products and the costs of raw materials, mainly natural gas.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS OF TIANYE CHEMICAL

The results of Tianye Chemical for the three months ended 31 March 2006 have been consolidated with those of our Company from 19 January 2006 and relevant disclosure has been included in note (e) of Section 8 of the accountants' report in Appendix IA to this Prospectus. The results of Tianye Chemical for the three months ended 31 March 2006 are therefore not presented separately.

Consolidated Income Statement

The following table sets forth, for the periods indicated, information relating to certain income and expense items and percentages of the revenue from the consolidated profit and loss accounts of Tianye Chemical:

	Year ended 31 December					
	2003		2004		2005	
Summary consolidated income statement data of Tianye Chemical	RMB	%	RMB	%	RMB	%
	(in millions, except for percentages or otherwise marked) (audited)					
Revenue	595.1	100.0	844.4	100.0	745.4	100.0
Cost of sales	(630.9)	(106.0)	(748.6)	(88.7)	(681.6)	(91.4)
Gross profit/(loss)	(35.8)	(6.0)	95.8	11.3	63.8	8.6
Other income and gains	2.5	0.4	19.8	2.3	19.5	2.6
Selling and distribution costs	(2.1)	(0.4)	(4.9)	(0.5)	(5.1)	(0.7)
Administrative expenses	(58.1)	(9.7)	(61.8)	(7.3)	(66.5)	(8.9)
Other expenses	(41.1)	(6.9)	(64.0)	(7.6)	(16.6)	(2.2)
Finance revenue	3.5	0.6	3.0	0.4	6.0	0.8
Finance costs	(60.9)	(10.2)	(69.2)	(8.2)	(64.7)	(8.7)
Exchange gain/(loss), net	(193.4)	(32.5)	(47.8)	(5.7)	236.6	31.7
Profit/(loss) before tax	(385.4)	(64.7)	(129.1)	(15.3)	173.0	23.2
Income tax credit/(expense)	18.1	3.0	(31.8)	(3.8)	—	0.0
Profit/(loss) for the year	(367.3)	(61.7)	(160.9)	(19.1)	173.0	23.2

2005 Compared with 2004

Revenue

Revenue of Tianye Chemical decreased by 11.7% from RMB844.4 million in the year ended 31 December 2004 to RMB745.4 million in the year ended 31 December 2005, mainly due to the significantly reduced sales volume in 2005, partly offset by the increases of average selling prices of the traditional prill urea products. In 2004 and 2005, approximately 99.5% and 99.3%, respectively, of Tianye Chemical's total revenue were from the production and sale of fertilizer products.

Total sales volumes of Tianye Chemical's traditional prill urea products decreased by 26.4% from 664,509 tonnes in the year ended 31 December 2004 to 489,239 tonnes in the year ended 31 December 2005, primarily due to the reduction of production volume from 583,650 tonnes in 2004 to 491,322 tonnes in 2005. The decrease in production volume in 2005 was principally due to a 77-day suspension of production while Tianye Chemical converted its facilities from oil-based to gas-based production in 2005. In addition, Tianye Chemical sold only 11,295 tonnes of traditional prill urea products in 2005 from inventory in 2004, compared with 92,816 tonnes of total traditional prill urea products sold in 2004 from inventory in 2003.

The average selling prices of Tianye Chemical's traditional prill urea products increased by 14.3% from RMB1,429 per tonne in 2004 to RMB1,634 per tonne in 2005. The increases in average selling prices of our traditional prill urea products in 2005 compared to 2004 were primarily due to the decreased domestic urea supply which began in 2003 and lasted until the first half of 2005. Since 2003, a number of international nitrogenous fertilizer producers suspended or ceased production due to significantly raised natural gas prices, reducing the supply of urea worldwide. The price of urea products in the international markets therefore experienced significant increases. As a result, Chinese nitrogenous fertilizer producers tended to export more urea products than they previously did and at higher selling prices. Increased export sales and decreased domestic supply of urea products drove the domestic selling prices of urea to increase in China.

In addition, since 1 July 2005, the PRC Government implemented a VAT exemption policy towards sales of urea products sold in China. Under IFRS, output VAT exemption is required to be accounted for as revenue. Thus, Tianye Chemical's revenue increased by RMB33.0 million from 2004 to 2005 due to the VAT exemption it enjoyed in 2005.

Cost of sales

Tianye Chemical's cost of sales decreased by 9.0% from RMB748.6 million in 2004 to RMB681.6 million in 2005. Its cost of sales accounted for 91.4% of revenue in 2005 compared to 88.7% in 2004. Tianye Chemical's cost of sales decreased in 2005 compared to 2004 primarily due to the decreased production volume caused by the suspension of production while Tianye Chemical converted its facilities and by the decrease in sales from inventory in 2005 compared to 2004, partly offset by the increases in residual oil prices from 2004 to 2005 until the conversion of Tianye Chemical's facilities. Tianye Chemical incurred depreciation costs of RMB167.2 million and RMB165.2 million in 2004 and 2005, respectively, for its production facilities, which was recorded in the cost of sales. The budgeted production cost of Tianye Chemical's traditional prill urea products made from oil was RMB255 per tonne higher than that of the same product made from natural gas. However, since 1 July 2005, the PRC Government implemented a VAT exemption policy towards urea products sold in China. Under IFRS, the input VAT of RMB22.9 million which Tianye Chemical has already paid for raw materials needs to be accounted into cost of sales, which partly offset the decrease in cost of sales of Tianye Chemical.

Gross profit

As a result of the foregoing, Tianye Chemical's gross profit decreased by 33.4% from RMB95.8 million in 2004 to RMB63.8 million in 2005. The gross profit margin of Tianye Chemical was 8.6% in 2005 compared to 11.3% in 2004. The decrease in gross profit margin in 2005 from 2004 was due primarily to the increase in residual oil prices, partially offset by the savings in material costs after the oil-to-gas conversion in October 2005.

Other income and gains

Other income and gains of Tianye Chemical decreased slightly by 1.5% from RMB19.8 million in 2004 to RMB19.5 million in 2005 which were mainly related to the VAT refund Tianye Chemical received.

Selling and distribution costs

Selling and distribution costs of Tianye Chemical increased by 4.1% from RMB4.9 million in 2004 to RMB5.1 million in 2005. The increase in selling and marketing costs was due primarily to changes in the basis of charging transportation costs to customers.

Administrative expenses

Administrative expenses of Tianye Chemical increased by 7.6% from RMB61.8 million in 2004 to RMB66.5 million in 2005. This increase was primarily a result of increases in the average salary of Tianye Chemical's administrative staff while the total number of administrative staff remained approximately the same.

Other expenses

Other expenses of Tianye Chemical decreased by 74.1% from RMB64.0 million in 2004 to RMB16.6 million in 2005. Decreases in other expenses were primarily caused by the higher provision for assets impairment in 2004 as compared to 2005. In 2004, a large portion of assets impairment was related to the conversion from oil-based to natural gas-based urea production at Tianye Plant.

Finance revenue

Tianye Chemical's finance revenue principally consisted of interest from bank deposits which increased from RMB3.0 million in 2004 to RMB6.0 million in 2005.

Finance costs

Tianye Chemical's finance costs decreased to RMB64.7 million in 2005 from RMB69.2 million in 2004. Decreases in finance costs from 2004 to 2005 were primarily due to the repayment of short-term bank borrowings, which resulted in interest expense savings.

Exchange gains/(losses), net

As of 31 December 2004 and 2005, Tianye Chemical had an outstanding balance of bank loans and related charges from the Export-Import Bank of China of JPY22.7 billion and JPY21.8 billion, respectively. As such, Tianye Chemical recorded foreign exchange loss of RMB47.8 million in 2004 due to the 3.2% appreciation of Japanese Yen against Renminbi from 31 December 2003 to 31 December 2004. Tianye Chemical recorded foreign exchange gains of RMB236.6 million in 2005, mainly due to the 13.8% depreciation of Japanese Yen against Renminbi from 31 December 2004 to 31 December 2005.

Income tax (credit)/expense

Income tax expense of Tianye Chemical decreased by 100% from RMB31.8 million in 2004 to nil in 2005. Although Tianye Chemical was profitable in 2005, it was exempt from corporate income tax due to the conversion of the Tianye Plant from residual oil-based to natural gas-based production. The income tax expenses in 2004 were therefore primarily due to the movement for the deferred tax provisions on tax losses recognized as deferred tax assets. In 2004, Tianye Chemical had utilized RMB29.7 million recognized in prior years, and hence resulted in a reduction in deferred tax assets as of 31 December 2004 from RMB52.7 million to RMB27.0 million.

Profit/(Loss) for the year

As a result of the foregoing factors, Tianye Chemical generated profit of RMB173.0 million in 2005 compared to a loss of RMB160.9 million in 2004.

2004 Compared with 2003

Revenue

Revenue of Tianye Chemical increased by 41.9% from RMB595.1 million in 2003 to RMB844.4 million in 2004. This increase was due primarily to the substantial increases in sales volume and average selling price of traditional prill urea products. In 2003 and 2004, approximately 99.4% and 99.5%, respectively, of Tianye Chemical's total revenue were from the production and sale of fertilizer products.

Although Tianye Chemical did not significantly increase its production volume of urea in 2004, total sales volumes of its traditional prill urea products increased by 22.4% from 543,015 tonnes in 2003 to 664,509 tonnes in 2004 because it sold urea products from inventory. Among the 664,509 tonnes of traditional prill urea products Tianye Chemical sold in 2004, approximately 92,816 tonnes, or 14.0%, were from the inventory that it produced in 2003, and only 583,650 tonnes, or 87.8%, were produced in 2004.

The average selling prices of the traditional prill urea products of Tianye Chemical increased by 16.2% from RMB1,230 per tonne in 2003 to RMB1,429 per tonne in 2004. Since 2003, a number of international nitrogenous fertilizer producers suspended or ceased production due to significantly raised natural gas prices, reducing the supply of urea worldwide. The price of urea products in the international markets therefore experienced significant increases. As a result, Chinese nitrogenous fertilizer producers tended to export more urea products than they previously did. Increased export sales resulted in the decrease of domestic urea supply and eventually, average selling price of urea increased, in China.

Cost of sales

Cost of sales of Tianye Chemical increased by 18.7% from RMB630.9 million in 2003 to RMB748.6 million in 2004. Cost of sales increased primarily as a result of the increases in sales volume, consisting of traditional prill urea produced in 2004 and sales from inventory. Tianye Chemical incurred depreciation costs of RMB190.4 million and RMB167.2 million in 2003 and 2004, respectively, for its production facilities, which was recorded in the cost of sales.

Gross profit/(loss)

As a result of the foregoing, Tianye Chemical had a gross loss of RMB35.8 million in 2003, compared to the gross profit of RMB95.8 million in 2004. Tianye Chemical's gross profit margin was 11.3% in 2004. Gross loss incurred by Tianye Chemical in 2003 was due primarily to the sharp increase in prices of residual oil which could not be shifted to the customers due to weak market demand of urea products in 2003.

Other income and gains

Other income and gains of Tianye Chemical increased by 692.0% from RMB2.5 million in 2003 to RMB19.8 million in 2004. This increase was due primarily to the VAT refund that Tianye Chemical received in 2004 and treated as a subsidy from the PRC Government. Tianye Chemical received nil VAT refund in 2003.

Selling and distribution costs

Selling and distribution costs of Tianye Chemical increased by 133.3% from RMB2.1 million in 2003 to RMB4.9 million in 2004. The increase in selling and distribution costs in 2004 was primarily caused by the increase in sales volume of 664,509 tonnes as compared to 543,015 tonnes in 2003 and increased transportation costs resulted from changes in the terms and conditions of our transportation services.

Administrative expenses

Administrative expenses of Tianye Chemical increased by 6.4% from RMB58.1 million in 2003 to RMB61.8 million in 2004. This increase was primarily due to increases in the average salary of Tianye Chemical's administrative staff while the total number of administrative staff remained approximately the same.

Other expenses

Other expenses of Tianye Chemical increased by 55.7% from RMB41.1 million in 2003 to RMB64.0 million in 2004. Increases in other expenses were primarily caused by the increased assets impairment relating to the facilities upgrade. The impairment relating to underground water equipment amounted to RMB35.3 million in 2003, compared to the impairment of RMB45.6 million in 2004. The impairment in 2003 was a result of the PRC Government's instruction for Tianye Chemical to cease its use of underground water and to begin using water sourced from the mid-stream of the Yellow River. The impairment in 2004 was related to Tianye Chemical's oil-to-gas conversion project as idle residue oil-based production machinery were impaired.

Finance revenue

Tianye Chemical's finance revenue decreased to RMB3.0 million in 2004 from RMB3.5 million in 2003. The decrease in finance revenue from 2003 to 2004 was primarily due to the decrease in interest earned from Tianye Chemical's bank deposits.

Finance costs

Tianye Chemical's finance costs increased by 13.6% from RMB60.9 million in 2003 to RMB69.2 million in 2004. The increase in finance costs from 2003 to 2004 was due primarily to the bank charges relating to late payment of interest in connection with the Japanese Yen loan in 2004.

Exchange loss, net

As of 31 December 2003 and 2004, Tianye Chemical had an outstanding balance of bank loans from the Export-Import Bank of China of JPY24.2 billion and JPY22.9 billion, respectively. As such, Tianye Chemical incurred foreign exchange loss of RMB193.4 million in 2003 and RMB47.8 million in 2004, respectively, mainly due to the 11.9% appreciation of the Japanese Yen against Renminbi from 31 December 2002 to 31 December 2003, and also to the 3.2% appreciation of Japanese Yen against Renminbi from 31 December 2003 to 31 December 2004.

Income tax expenses

Income tax expenses of Tianye Chemical increased from an income tax credit of RMB18.1 million in 2003 to an income tax expense of RMB31.8 million in 2004. The increase in income tax expenses was primarily due to the adjustment of accounting treatment for the deferred tax provisions on tax losses, asset impairment and provision against asset. As of 31 December 2003, Tianye Chemical recognized RMB29.7 million as deferred tax benefit arising from unutilized tax losses which was entirely utilized to offset taxable profit in 2004.

Loss for the year

As a result of the foregoing factors, Tianye Chemical's loss for the year decreased by 56.2%, or RMB206.4 million, from RMB367.3 million to RMB160.9 million.

Liquidity and Capital Resources

Tianye Chemical funds its operations principally from internal funds, proceeds from the sale of its products, prepayments received from customers and provision of its services, capital contribution from its shareholders and bank and other borrowings.

As of 31 December 2005, Tianye Chemical's current assets amounted to RMB299.8 million, representing a decrease of RMB365.3 million from RMB665.1 million as of 31 December 2004. The decrease was mainly attributable to a decrease of RMB371.1 million in cash and bank balances due to decreased cash and cash equivalents and time deposits secured for letters of credit in relation to purchases of machinery and equipment. In addition, the payments relating to the construction of the oil-to-gas conversion project and the construction of the new methanol plant decreased to RMB20.9 million in 2005 from RMB142.6 million in 2004 as a result of repayments made during 2005. The decrease in Tianye Chemical's current assets was partially offset by an increase of RMB5.6 million in prepayments, deposit and other receivables due to the receipt of advance payments from customers in relation to sales of Tianye Chemical's products and an increase of RMB3.2 million in trade receivables due to unpaid sales invoices at the end of 2005.

As of 31 December 2005, Tianye Chemical's current liabilities amounted to RMB882.9 million representing an increase of RMB109.9 million from RMB773.0 million as of 31 December 2004. The increase was mainly attributable to an increase of RMB216.4 million in other payables and accruals due to (i) an increase of RMB148.9 million in the amount owed by Tianye Chemical to the Inner Mongolia Finance Bureau in connection with its delayed partial repayment of the Japanese Yen denominated loan which the Inner Mongolia Finance Bureau paid on its behalf, and (ii) an increase of RMB47.3 million in other payables mainly consisting of the retention sums relating to the construction expenses for the oil-to-gas conversion project, which served as quality assurances for the project. The increase in current liabilities was partially offset by a decrease of RMB105.5 million in bank and other borrowings due within one year.

Pursuant to four tripartite loan transfer agreements entered into between the Export-Import Bank of China, Tianye Chemical and the Inner Mongolia Finance Bureau, Tianye Chemical transferred to the Inner Mongolia Finance Bureau approximately RMB1,426.9 million of its unsecured Japanese Yen denominated bank loans, the related penalty interest and late fee payables. Upon completion of these loan transfer agreements and as a result of the waiver by the Finance Bureau, in February 2006, Tianye Chemical repaid a total amount of JPY10.4 billion (equivalent to RMB716.2 million) and RMB188.8 million to the Inner Mongolia Finance Bureau by means of an unsecured entrusted loan of RMB910.0 million from our Company, bearing interest of 2.07% payable by 21 August 2006. The loan, however, was settled in full in June 2006.

Cash Flow

Primary uses of cash by Tianye Chemical are to invest in additional manufacturing facilities and equipment, service its indebtedness, and to fund working capital and normal recurring expenses. As of 31 December 2005, Tianye Chemical had cash and cash equivalents of RMB42.6 million, excluding non-pledge time deposits of RMB100.0 million with original maturity of three months or more when acquired and pledged savings of RMB20.9 million. The following table sets out changes in cash flows for each of the three years ended 31 December 2003, 2004 and 2005:

	Year ended 31 December		
	2003	2004	2005
	(RMB million)		
Cash and cash equivalents at beginning of year	251.5	291.5	92.0
Net cash flows generated from operating activities	53.1	447.4	262.3
Net cash flows used in investing activities	(10.5)	(644.6)	(258.7)
Net cash flows used in financing activities	(2.6)	(2.3)	(53.0)
Net increase/(decrease) in cash and cash equivalents	40.0	(199.5)	(49.4)
Cash and cash equivalents at end of year	291.5	92.0	42.6

Cash generated from operating activities

Net cash generated from operating activities decreased 41.4% to RMB262.3 million for the year ended 31 December 2005 from RMB447.4 million for the year ended 31 December 2004. The decrease of RMB185.1 million was attributable to unrealized foreign exchange gains and an increase in trade receivables, bills receivables, prepayments, deposits and other receivables amounting to RMB8.1

million for the year ended 31 December 2005, compared to a decrease in trade and bills receivables, prepayments, deposits and other receivables amounting to RMB161.8 million for the year ended 31 December 2004. The net cash generated from operating activities was further enhanced by an increase in trade payables, other payables and accruals amounting to RMB72.6 million for the year ended 31 December 2005, compared to a decrease amounting to RMB8.2 million for the year ended 31 December 2004 due to increases in advances from Tianye Chemical's customers and higher bonuses accrual for 2005 and a decrease in inventories of RMB2.5 million in 2005 compared to RMB58.7 million in 2004.

Net cash generated from operating activities increased 742.6% to RMB447.4 million for the year ended 31 December 2004 from RMB53.1 million for the year ended 31 December 2003. The increase of RMB394.3 million was attributable to (i) a decrease in trade receivables, bills receivables, prepayments, deposits and other receivables amounting to RMB161.8 million for the year ended 31 December 2004 because Tianye Chemical demanded prepayments before delivery of products and did not accept bill receivables as payment method due to high market demand for fertilizers in 2004, compared to an increase amounting to RMB35.2 million for the year ended 31 December 2003; (ii) a decrease in inventories amounting to RMB58.7 million for the year ended 31 December 2004, compared to an increase of RMB17.4 million for the year ended 31 December 2003 because Tianye Chemical's sale of 92,816 tonnes of traditional prill urea in 2004 reduced its inventories at the end of 2004 compared to the end of 2003; and (iii) a decrease in trade payables, other payables and accruals amounting to RMB8.2 million for the year ended 31 December 2004 as compared to a decrease of RMB10.1 million for the year ended 31 December 2003.

Cash used in investing activities

Net cash used in investing activities decreased 59.9% to RMB258.7 million for the year ended 31 December 2005 from RMB644.6 million for the year ended 31 December 2004. The decrease of RMB385.9 million was mainly attributable to a decrease in non-pledged deposits and guaranteed savings of RMB321.7 million for the year ended 31 December 2005, compared to an increase of RMB442.6 million for the year ended 31 December 2004, which was partially offset by an increase in cash used in the purchase of fixed assets for the oil-to-gas conversion project to RMB586.4 million for the year ended 31 December 2005 from RMB204.9 million for the year ended 31 December 2004.

Net cash used in investing activities increased 6,039.0% to RMB644.6 million for the year ended 31 December 2004 from RMB10.5 million for the year ended 31 December 2003. The increase of RMB634.1 million was mainly attributable to RMB204.9 million used for the purchase of fixed assets and an increase in non-pledged deposits and pledged savings of a total of RMB442.6 million in connection with the execution of the contracts for the oil-to-gas conversion projects for the years ended 31 December 2004 whereas the purchase of fixed assets was RMB14.0 million only and there was no such cash pledged for the year ended 31 December 2003.

Cash used in financing activities

Net cash used in financing activities increased 2,204.3% to RMB53.0 million for the year ended 31 December 2005 from RMB2.3 million for the year ended 31 December 2004. The increase was mainly attributable to Tianye Chemical's repayment of short-term secured bank loans amounting to RMB50.0 million during 2005.

Net cash used in financing activities decreased slightly from RMB2.6 million in 2003 to RMB2.3 million in 2004. The cash used was mainly attributable to interest expenses incurred in respect of short-term loans.

Working Capital

Tianye Chemical has historically met its working capital needs through cash generated by operations, advances from shareholders and long- and short-term debts. Tianye Chemical utilizes deposits it receives from its customers to finance in part its working capital requirements. These deposits received amounted to RMB46.9 million as of 31 December 2005. On the other hand, Tianye Chemical makes prepayments to its suppliers which form part of its working capital requirements. Such prepayments amounted to RMB15.3 million as of 31 December 2005.

As of 31 December 2005, Tianye Chemical had no credit facilities except banking facilities.

Trade Receivables, Inventory and Trade Payables Turnover

The following table sets forth the turnover days of the trade receivables, inventories and trade payables of Tianye Chemical for the periods indicated:

	For the year ended 31 December		
	2003	2004	2005
		(days)	
Turnover days of trade receivables[(1)]	3.8	1.6	1.4
Turnover days of inventories[(2)]	95.1	70.1	60.5
Turnover days of trade payables[(3)]	17.3	9.9	4.4

(1) Turnover days of trade receivables is derived by dividing turnover by the arithmetic mean of the opening and closing balances of trade receivables for the relevant period and multiplying by 365 days.

(2) Turnover days of inventories is derived by dividing cost of sales by the arithmetic mean of the opening and closing balances of inventory for the relevant period and multiplying by 365 days.

(3) Turnover days of trade payables is derived by dividing cost of sales by the arithmetic mean of opening and closing balances of trade payables, for the relevant period and multiplying by 365 days.

Due to strong demand for its products and for the purpose of managing credit risks, Tianye Chemical normally requires payment in advance from most of its customers. Tianye Chemical seeks to maintain strict control over trade receivables and has a credit control policy to minimize credit risks. Tianye Chemical generally writes off the full amount of its debts for which collection is no longer possible, taking into consideration certain factors such as the financial condition of the customers and the age of such debts. A significant improvement in the turnover rate for trade receivables from 2003 to 2004 was due primarily to the enhanced credit control policy introduced and implemented by the new management team.

The inventory turnover days of Tianye Chemical improved significantly from 2003 to 2004 due to market reasons, and further improved in 2005 due to reduced raw materials storage. The reductions were attributable to a new inventory policy introduced by the new management team in 2004.

The fluctuation of the turnover days of trade payables in the years ended 31 December 2003, 2004 and 2005 was caused by the timing of the settlement to Tianye Chemical's suppliers of materials.

Indebtedness

Borrowings

Consolidated borrowings of Tianye Chemical as of 31 December 2003, 2004 and 2005 were as follows:

	As of 31 December		
	2003	2004	2005
	(RMB million)		
Secured bank loans	50.0	50.0	—
Unsecured bank loans	1,832.0	1,767.9	1,449.7
Obligation under finance lease	—	—	1.4
Total	1,882.0	1,817.9	1,451.1

The above borrowings during the Track Record Period bore interest at effective rates ranging from 2.25% to 5.31% per annum.

The maturity profile of the borrowings of Tianye Chemical as of 31 December 2003, 2004 and 2005 was as follows:

	As of 31 December		
	2003	2004	2005
	(RMB million)		
Bank loans repayable:			
Within one year or on demand	378.1	348.9	242.7
In the second year	156.9	162.7	152.5
In the third to fifth years, inclusive	242.1	249.7	215.3
Beyond five years	1,104.9	1,056.6	839.2
Total	1,882.0	1,817.9	1,449.7
Other loans repayable:			
Within one year or on demand	—	—	0.7
In the second year	—	—	0.7
Total	—	—	1.4

The gearing ratio of Tianye Chemical was 68.2%, 66.9% and 52.9% for the years ended 31 December 2003, 2004 and 2005, respectively. Gearing ratio is derived by dividing total interest-bearing bank and other borrowings by total assets. The significant reduction in gearing ratio for the year ended 31 December 2005 was mainly due to the repayment of both short-term and long-term borrowings in 2005.

Included in the above consolidated borrowings as of 31 December 2005 were unsecured bank loans with guarantees of RMB1,449.7 million and finance lease obligations without guarantees of RMB1.4 million.

As of 31 December 2003 and 2004, Tianye Chemical had bank loans of RMB50 million secured by mortgages over certain machinery and land use rights. Such loans were fully repaid during the year 2005 and as of 31 December 2005, there were no secured bank or other borrowings.

As of 31 December 2003, 2004 and 2005, the balance of Tianye Chemical's loans payable to the Inner Mongolia Finance Bureau were RMB68.8 million, RMB221.2 million and RMB370.1, million, respectively.

Contractual Obligations

The following table sets forth the scheduled maturities of Tianye Chemical's material contractual obligations as of 31 December 2005:

	Payments due as of years ended 31 December		
	2006	2007 to 2010	2011 and after
		(RMB million)	
Debt obligations[1]	242.7	367.8	839.2
Finance lease obligations[2]	0.7	0.7	—
Capital expenditure[3]	30.8	—	—
Total	274.2	368.5	839.2

(1) Include bank loans.

(2) Include payments for leases of office equipment. Terms for the leases ranged from one to three years. The leases have a term of renewal but no purchase option clause.

(3) Includes payment for acquisition of property, plant and equipment.

Contingent Liabilities

Tianye Chemical did not have any outstanding loan capital, bank overdrafts, and liabilities under acceptances or other similar indebtedness, debentures, mortgages, charges or loans or acceptance credits or hire purchase commitments, or guarantees or other material contingent liabilities outstanding as of 31 December 2005, apart from intra-company liabilities, which have been disregarded for these purposes.

Capital Commitments

Set forth below are the aggregate amounts of Tianye Chemical's capital commitments as of 31 December 2003, 2004 and 2005:

	As of 31 December		
	2003	2004	2005
		(RMB million)	
Contracted, but not provided for:			
In respect of the acquisition of plant and machinery	17.8	68.0	30.8
Authorized, but not contracted for:			
In respect of the acquisition of plant and machinery	507.3	122.4	—
Total	525.1	190.4	30.8

Tianye Chemical recorded an amount of interest-bearing bank loans denominated in Japanese Yen borrowed from the Export-Import Bank of China, related penalty interest and late fee payables thereon due to the late repayment of the Japanese Yen loans (collectively the "Japanese Yen Loan Obligations") as of 19 January 2006. In addition, it also had an amount due to the Inner Mongolia Finance Bureau (the "Finance Bureau") arising from the previous settlement of part of the Japanese Yen loan obligations with the Export-Import Bank of China by the Finance Bureau on behalf of

Tianye Chemical. Pursuant to the document Caijin (2006) No.3 (the "MOF Document") issued by the Ministry of Finance on 12 January 2006, there was a waiver of the entire penalty interest and late fee payables, and 50% of certain related bank charges included Tianye Chemical's Japanese Yen Loan Obligations as of 31 December 2005 (the "Waiver"). In connection with the acquisition of Tianye Chemical by our Company, and pursuant to the MOF Document, on 28 February 2006, Tianye Chemical entered into four tripartite loan transfer agreements with the Export-Import Bank of China and the Finance Bureau under which it transferred its Japanese Yen Loan Obligations to the Finance Bureau. After the completion of the above-mentioned transfer, Tianye Chemical, however, was required to pay the Finance Bureau 50% of the Japanese Yen Loan Obligations after the Waiver. Consequently, the Finance Bureau has in effect agreed to assume 50% of Tianye Chemical's Japanese Yen Loan Obligations after the Waiver. In addition, in connection with the four tripartite loan transfer agreements, the Finance Bureau has waived 50% of the amount due to it by Tianye Chemical arising from its previous settlement of part of the Japanese Yen loan obligations on behalf of Tianye Chemical.

Upon completion of the aforesaid loan transfers and as a result of the waiver by the Finance Bureau (collectively, the "Take-over"), in February 2006, the total obligations of Tianye Chemical in respect of the Japanese Yen loans, penalty interest and late fee payables, and the amount due to the Inner Mongolia Finance Bureau would be reduced by a total amount of approximately RMB1,019.3 million or from a combined amount of approximately RMB1,917.8 million as of 19 January 2006 to RMB898.5 million. Tianye Chemical repaid an amount of approximately RMB904.9 million to the Inner Mongolia Finance Bureau in February as discussed in "—Management's discussion and analysis of financial condition and results of operations of our Company—Indebtedness—Borrowings". The difference between RMB904.9 million and RMB898.5 million reflected the appreciation of the Japanese Yen. As a result of the transfer of loans from Tianye Chemical to the Finance Bureau, the net assets of Tianye Chemical increased by approximately RMB1,019.3 million. The Take-over was considered as a part of the acquisition of Tianye Chemical by our Directors and the above-mentioned increase in net assets of Tianye Chemical had been included in the computation of the excess over the cost of a business combination.

WORKING CAPITAL CONFIRMATION

We expect to fund our working capital needs with a combination of cash generated from operating activities, short-term bank loans, and other debt and equity financing. Taking into account our net cash flow from operating activities, the estimated net proceeds from the Global Offering and our credit facilities maintained with our banks and financial institutions amounting to approximately RMB1,401.0 million as of 31 July 2006 (including the renewal or extension of these banking facilities upon their expiration or subsequent new banking facilities), and the distribution of the 2005 Special Dividend and Pre-IPO Profit, the repayment of RMB1,410.0 million to CNOOC and our net current liabilities position as of 31 July 2006 and future commitments, our Directors are satisfied after due and careful enquiry that we have available sufficient working capital for our present requirements that is for at least the next 12 months from the date of this Prospectus.

PROFIT FORECAST

We believe that on the bases and assumptions as set forth below and in the absence of unforeseen circumstances, the consolidated profit attributable to the shareholders of our Company for the year ending 31 December 2006 is unlikely to be less than RMB1,460.5 million which included the excess over the cost of a business combination in connection with the acquisition of Tianye Chemical of RMB577.6 million as determined under IFRS. We are currently unaware of any extraordinary items that have arisen or are likely to arise in respect of the year ending 31 December 2006 that would affect the prospective financial information presented. The unaudited pro forma forecast earnings per Share is estimated to be not less than RMB33.19 cents (or approximately HK$32.43 cents), the calculation of which is based on the forecast consolidated net profit attributable to equity holders of the parent for the year ending 31 December 2006 and a total of 4,400,000,000 Shares issued and outstanding during the entire year, adjusted, as if the Global Offering had occurred on 1 January 2006, but without taking into account any Shares which may be issued upon exercise of the Over-allotment Option.

Bases and Assumptions

The prospective financial information has been prepared on a basis of the accounting policies consistent in all material respects with those adopted by us as set out in the Accountants' Report in Appendix IA to this Prospectus, and on bases and assumptions including the following:

- there will be no material change in existing political, legal, fiscal, market or economic conditions in China, Hong Kong, or any other country or territory in which we currently operate or which are otherwise material to our business;
- there will be no changes in legislation, regulations or rules in China, Hong Kong or any other country or territory in which we operate or with which we have arrangements or agreements, which materially adversely affect our business;
- there will be no material change in the bases or rates of taxation in China or any other country or territory in which we operate, except as otherwise disclosed in this Prospectus;
- there will be no material changes in inflation rates, interest rates or foreign currency exchange rates from those currently prevailing; and
- our operations will not be materially affected or interrupted by any force majeure events or unforeseeable factors or any unforeseeable reasons that are beyond the control of the Directors, including but not limited to the occurrence of natural disasters, epidemics or serious accidents.

DIVIDEND POLICY

After completion of the Global Offering, our shareholders will be entitled to receive dividends declared by us. The payment and the amount of any dividends will be at the discretion of our Board. Any dividend distribution shall also be subject to approval of our shareholders. Under the PRC Company Law and our Articles of Association, all of our shareholders have equal rights to dividends and distributions. For holders of our H Shares, cash dividend payments, if any, will be declared by our Board in RMB and paid in Hong Kong dollars.

In accordance with the applicable requirements of the Company Law, we may only distribute dividends after we have made allowance for:

- cumulative prior year losses, if any;
- allocation to the statutory common reserve fund (the allocation to the statutory common reserve fund each year is 10% of our after-tax profit, until the aggregate amount of such reserve fund exceeds 50% of the registered capital of our Company);

- allocation to a discretionary common reserve fund if approved at our shareholders' general meeting and after allocation is made to the statutory reserve fund.

Upon the listing of our H Shares on the Hong Kong Stock Exchange, our dividends may be paid only out of distributable profits as determined in accordance with PRC GAAP and IFRS, whichever is lower, less allocations to the statutory and discretionary common reserve funds.

In addition, the declaration of dividends is subject to the discretion of our Board which we expect will consider the following factors:

- general business condition and strategies;
- cash flows;
- our financial results;
- our capital requirements;
- interests of our shareholders;
- taxation conditions;
- statutory and regulatory restrictions; and
- any other factors which our Board may deem relevant.

We intend to distribute 20% to 30% of our net profit for the periods subsequent to the Global Offering.

We can give no assurance that any dividends will be paid. You should consider the bases and assumptions underlying our forecasts contained in the section headed "—Profit forecast", the risk factors affecting our Company contained in the section headed "Risk Factors" and the cautionary notice regarding forward-looking statements contained in the section headed "Forward-looking Statements".

In addition, on 6 March 2006, we declared, as a commercial decision, a special dividend of approximately RMB1,210.8 million to CNOOC, which is equal to our distributable profit as of 31 December 2005 (the "2005 Special Dividend") as determined in accordance with PRC GAAP. CNOOC is the only shareholder entitled to the 2005 Special Dividend because it was the sole shareholder of CNOOC Chemical, our predecessor, as of 31 December 2005. The funds for paying the 2005 Special Dividend will be sourced from our cash and cash equivalents generated from our operating activities and, if necessary, bank borrowings. The payment of the 2005 Special Dividend to CNOOC will be made before the Listing Date.

In accordance with the "Provisional Regulations Relating to Corporate Reorganization of Enterprises and Related Management of State-owned Capital and Financial Treatment," issued by the MOF (the "Provisional Regulations"), we are required to make a distribution (the "Pre-establishment Distribution") to CNOOC in the amount equal to the net profit attributable to shareholders generated by CNOOC Chemical during the period from 1 January 2006 to 24 April 2006, the date immediately prior to the date on which CNOOC Chemical was restructured to be our Company as a joint stock limited company (the "Relevant Profit Period"). The Provisional Regulations do not specify any requirement as to the method and timing of the Pre-establishment Distribution. Our income statement for the period from 1 January 2006 to 30 April 2006 was prepared under PRC GAAP and was reviewed by our auditors. The amount of the Pre-establishment Distribution required under the Provisional Regulations to be made to CNOOC was agreed among the Promoters with reference to such reviewed income statement to be RMB264.5 million and the payment will be made to CNOOC before the Listing Date from our cash and cash equivalents generated from our operating activities and, if necessary, bank borrowings secured before the Listing Date. Further, our Promoters agreed that we shall distribute to each of Zhejiang AMP, Guangdong AMP, Shanghai AMP and Transammonia an amount equal to the net profit of CNOOC Fudao attributable to shareholders generated by each shareholder's respective share in the equity interest of CNOOC Fudao contributed to our Company during the Relevant Profit Period. CNOOC Fudao's income statement for the period from 1 January 2006 to 30 April 2006 was prepared under PRC GAAP and was reviewed by our auditors. The aggregate amount of distributions to Zhejiang AMP, Guangdong AMP, Shanghai AMP and Transammonia was agreed with us by reference to such reviewed income statement to be RMB11.6 million and the payments will be made to the four Promoters before the Listing Date from our cash and cash equivalents generated from our operating activities and, if necessary, bank borrowings secured before the Listing Date. For further details, see "Appendix IC—Unaudited Interim Financial Report of our Company".

On 11 September 2006, to finance our payments of the 2005 Special Dividend and the Pre-establishment Distribution, we borrowed RMB540.0 million short-term bank loans as described in "—Indebtedness".

It was considered by our Promoters that our profits generated from the date of our Company's establishment until the listing of our H Shares on the Hong Kong Stock Exchange were largely the outcome of their investments in our Company from the financial perspective. On 25 April 2006, our five Promoters unanimously resolved, as a commercial decision based on the above-mentioned rationale, that they will be entitled to, in the same proportion as their respective shareholdings in us, all of the undistributed profit of our Company generated during the period from 25 April 2006, the date on which our Company was established and restructured to be a joint stock limited company, to the last day of the month immediately preceding the Listing Date (the "Pre-IPO Profit"). Assuming the Listing Date is in September 2006, we estimate that the Pre-IPO Profit will be approximately RMB312.0 million, calculated as 129 (being the number of days from 25 April 2006 to 31 August 2006)/365 of our forecast net profit for the year ending 31 December 2006, excluding the excess over the cost of a business combination of RMB577.6 million. The Pre-IPO Profit will be determined in accordance with PRC GAAP. We will make a public announcement when the amount of the Pre-IPO Profit has been ascertained. The payment of the Pre-IPO Profit to our five Promoters will be made after the Listing Date using our cash and cash equivalents generated from our operating activities and, if necessary, bank borrowings.

None of the 2005 Special Dividend, the Pre-establishment Distribution or the Pre-IPO Profit is indicative of the dividends that our Company may declare or pay in the future. Holders of H Shares are not entitled to share in the 2005 Special Dividend, the Pre-establishment Distribution or the Pre-IPO Profit. Any distributable profits available for distribution to our shareholders after the Global Offering will exclude the respective amounts of the 2005 Special Dividend, the Pre-establishment Distribution and the Pre-IPO Profit.

INTERNAL CONTROLS

Until recently, as a PRC company, we did not prepare consolidated financial statements in accordance with IFRS. In addition, we recently began to migrate to a new ERP system to process the accounting data. We are in the process of upgrading our internal reporting control, accounting and financial systems in order to improve and strengthen our internal controls and management information system. For example, we are further computerizing our recordkeeping systems, introducing procedures to coordinate recordkeeping among our various departments and subsidiaries and improving our inventory management systems. We believe that with these improvements our management will be able to obtain better quality and more timely information, which would also assist us in preparing financial statements.

RELATED PARTY TRANSACTIONS

With respect to related parties transactions as set out in note 5(*l*) of the Accountants' Report of our Company in Appendix IA to this Prospectus and in note 5(*j*) of the Accountants' Report of Tianye Chemical in Appendix IB to this Prospectus, our Directors are of the view that these transactions were conducted on normal commercial terms and have been entered into in our ordinary course of business.

DISTRIBUTABLE RESERVES

As of 31 December 2005, we had distributable profits amounting to approximately RMB1,210.8 million, which was determined under PRC GAAP after deduction of the minimum transfers to the statutory surplus reserve as set out above. The 2005 Special Dividend in the same amount payable to CNOOC was declared on 6 March 2006.

PRO FORMA ADJUSTED NET TANGIBLE ASSETS

The following statement of our unaudited pro forma adjusted net tangible assets as of 31 March 2006 comprises our historical audited consolidated net tangible assets as of 31 March 2006, as shown in the accountants' report, the text of which is set out in Appendix II to this Prospectus and the adjustments described below.

The unaudited pro forma adjusted net tangible assets have been prepared to show the effect on our and our subsidiaries' audited net tangible assets as of 31 March 2006 as if the Pre-establishment Distribution, the estimated Pre-IPO Profit and the Global Offering had occurred on 31 March 2006.

Our unaudited pro forma adjusted net tangible assets have been prepared for illustrative purposes only and, because of its nature, it may not give a true picture of our financial position.

	Audited net tangible assets attributable to equity holders of the parent as of 31 March 2006	Estimated net proceeds receivable by our Company from the Global Offering	Unaudited pro forma adjusted net tangible assets	Unaudited pro forma adjusted net tangible assets per Share	Unaudited pro forma adjusted net tangible assets per Share
	RMB'000	RMB'000	RMB'000	RMB	(HK$ equivalent)
Based on an Offer Price of HK$1.38 per H Share . .	3,336,693	1,866,353	5,203,046	1.183	1.156
Based on an Offer Price of HK$1.90 per H Share . .	3,336,693	2,585,270	5,921,963	1.346	1.315

(1) The calculation of the unaudited pro forma adjusted net tangible assets per Share did not take into account the declaration of the Pre-establishment Distribution and the estimated Pre-IPO Profit after the balance sheet date of 31 March 2006 but immediately preceding the date of the Company's listing on the Hong Kong Stock Exchange, which, after taking place, will decrease the unaudited pro forma adjusted net tangible assets per Share. For further details, see "Appendix II—Unaudited pro forma financial information—Unaudited pro forma adjusted net tangible assets".

DISCLOSURE UNDER RULES 13.11 TO 13.19 OF THE HONG KONG LISTING RULES

The Directors confirm that as of the Latest Practicable Date, there were no circumstances which would give rise to the disclosure requirements under Rules 13.11 to 13.19 of the Hong Kong Listing Rules had the H Shares been listed on the Hong Kong Stock Exchange on that date.

NO MATERIAL ADVERSE CHANGE

Save as disclosed in "—Management's discussion and analysis of financial condition and results of operations of our Company—Indebtedness" and "—Dividend policy", we have confirmed that there has been no material adverse change in our financial or trading position since 31 March 2006 (being the date to which our Company's latest consolidated financial results were prepared, as set out in the Accountants' Report in Appendix IA to this Prospectus).