

MANAGEMENT DISCUSSION AND ANALYSIS

In 2005, the Company took efforts in exploring production potential, adjusting product mix and promoting sales with stable product prices, together with consumption and cost reductions, thus achieving a growth in production and sales volumes and sales revenue. However, its profitability was considerably reduced as a result of the declined steel product prices and increased material and fuel prices. For the year ended 31st December 2005, the sales revenue of the Company amounted to Rmb8,856,126,000, representing an increase of 3.56% from last year. Profit before taxation was Rmb275,644,000 and earnings per share amounted to Rmb0.217, representing a decrease of 68.40% and 72.64% from last year respectively.

1. Sales

In 2005, the Company's sales revenue amounted to Rmb8,856,126,000, of which Rmb8,313,125,000 was derived from sales of steel products (billets), representing 93.87% of the total revenue, an increase of 3.29% from last year, and Rmb543,001,000 was derived from sales of non-steel products, such as water granulated slag, coking by-products, cutting steel leftover and provision of utilities including water and electricity, which accounted for 6.13% of the total revenue, an increase of 7.88% from last year.

| | 2005 | | 2004 | | Year-on-year growth |
|-------------------------|----------------------|-------------------|----------------------|-------------------|------------------------|
| | Amount (Rmb0'000) | Percentage (%) | Amount (Rmb0'000) | Percentage (%) | |
| Turnover | | | | | |
| Steel plates | 403,392 | 45.55 | 379,244 | 44.34 | 6.37 |
| Steel sections | 185,086 | 20.90 | 190,789 | 22.31 | -2.99 |
| Wire rods | 100,657 | 11.37 | 103,615 | 12.12 | -2.85 |
| Steel billets | 119,386 | 13.48 | 131,209 | 15.34 | -9.01 |
| Cold rolled thin plates | 22,792 | 2.57 | — | — | — |
| Subtotal | 831,313 | 93.87 | 804,857 | 94.11 | 3.29 |
| Others | 54,300 | 6.13 | 50,335 | 5.89 | 7.88 |
| Total | 885,613 | 100 | 855,192 | 100 | 3.56 |

In 2005, the sales revenue of the Company's steel products (billets) increased by Rmb264,549,000 as compared with last year, which was attributable to an increase in production and sales volume partially offset by a decrease in selling prices. During the year, the Company sold 2,396,100 tonnes of steel products (billets), representing an increase of 4.48% over last year which increased sales revenue by Rmb446,200,000. Meanwhile, the average selling prices of steel products (billets) was Rmb3,469 per tonne, representing a decrease of 1.14% from last year which decreased sales revenue by Rmb181,651,000.

MANAGEMENT DISCUSSION AND ANALYSIS (CONTINUED)

| | 2005 (0'000 tonnes) | 2004 (0'000 tonnes) | Year-on-year increase (%) | Contribution to revenue (Rmb0'000) |
|---------------------------------|------------------------|------------------------|---------------------------------|--|
| Sales volume by products | | | | |
| Steel plates | 103.02 | 94.36 | 9.18 | 34,805 |
| Steel sections | 59.29 | 60.17 | -1.46 | -2,790 |
| Wire rods | 32.94 | 33.71 | -2.28 | -2,367 |
| Steel billets | 38.65 | 41.1 | -5.96 | -7,820 |
| Subtotal | 233.90 | 229.34 | 1.99 | 21,828 |
| Cold rolled thin plates | 5.71 | — | — | 22,792 |
| Total | 239.61 | 229.34 | 4.48 | 44,620 |

| | 2005 (RMB/tonnes) | 2004 (RMB/tonnes) | Year-on-year increase (%) | Contribution to revenue (Rmb0'000) |
|----------------------------------|----------------------|----------------------|---------------------------------|--|
| Selling price by products | | | | |
| Steel plates | 3,915 | 4,019 | -2.59 | -10,686 |
| Steel sections | 3,122 | 3,171 | -1.55 | -2,905 |
| Wire rods | 3,056 | 3,074 | -0.59 | -593 |
| Steel billets | 3,089 | 3,192 | -3.23 | -3,981 |
| Average selling price | 3,457 | 3,509 | -1.48 | -18,165 |
| Cold rolled thin plates | 3,993 | — | — | — |
| Total | 3,469 | 3,509 | -1.14 | -18,165 |

II. Profitability

The Company's profit before taxation for 2005 decreased by Rmb596,512,000, or 68.40%, to Rmb275,644,000 as compared with last year, of which:

- Gross profit amounted to Rmb728,033,000, representing a decrease of Rmb586,794,000 as compared with last year. Gross profit margin was 8.22%, decreasing by 7 percentage points from last year. This is mainly attributable to:

MANAGEMENT DISCUSSION AND ANALYSIS (CONTINUED)

- (1) The prices of steel products of the Company have been significantly declining since April 2005 and dived to the bottom at the end of the year, of which the decrease in smelting and rolled products reached 26%. Such decrease, coupled with the sales volume of smelting and rolled products amounting to 2,339,000 tonnes, contributed a decrease of Rmb181,651,000 to gross profit.
 - (2) By consumption and costs reduction, the Company managed to offset the impact of the increased prices of raw materials including ore, coal, pig iron, scrap steel together with the increase in electricity tariff, totalling Rmb551,970,000, on the gross profit.
2. Other gains amounted to Rmb6,463,000, representing a year-on-year increase of Rmb16,154,000.
3. Sales and marketing costs amounted to Rmb150,380,000, representing an increase of Rmb11,444,000 as compared with last year. This was mainly due to the increase in shipbuilding inspection expenses as result of the expanded sales volume of steel plats for shipbuilding.
4. Administrative expenses amounted to Rmb176,352,000, representing a decrease of Rmb26,481,000 as compared with last year. This was mainly attributable to the decrease in labour cost during the year.
5. Finance costs amounted to Rmb132,120,000, representing an increase of Rmb40,909,000 as compared with last year. This was mainly attributable to the increase in interest expenses resulting from the increased bank loans.

III. Financial Position

1. As of 31st December 2005, total assets of the Company amounted to Rmb8,132,279,000, representing a year-on-year increase of 12.94%. The gearing ratio was 51.85%, 5 percentage points higher than that of last year. Meanwhile, the current assets/current liabilities ratio was 88.03%.
2. In 2005, net cash inflow from operating activities of the Company amounted to Rmb95,751,000. Net increase in the Company's bank loans amounted to Rmb835,865,000 to finance series of technology renovations for production expansion. During 2005, the Company's investment in acquisition and construction of property, plant and equipment amounted to Rmb1,254,098,000, mainly including renovation of coke furnaces No. 1 and No.2, renovation and expansion of first sintering house, relocaton and renovation of blast furnace No.4, project of converter furnace No. 4, expansion and renovation of medium plate plant, the cool rolled sheet/strip projects, etc.