

V. Management Discussion and Analysis

(1) Business Review

(1) For the six months ended 30 June 2001, the macro-economic environment in the PRC has been favourable. Demand for iron and steel in the market was great and consumption of steel products had a stable growth. However, vibrant iron and steel markets led to substantial increase in supply of iron and steel products, in particular, exports were restricted due to decreased demand for iron and steel in international markets while there were abundant imported iron and steel products. Therefore, there was a fiercer market competition for iron and steel products. Product prices of the Company decreased slightly by 7.32% on the whole when compared to those in 2000.

The Company adopted a number of effective measures to strengthen its production and operations. The Company produced 1,939,000 tonnes of steel products in the first half of 2001, an increase of 12.86% as compared with the figure for the same period last year; of which cold rolled sheets accounted for 537,000 tonnes, an increase of 2.09% from the figure for the same period last year; wire rods accounted for 485,000 tonnes, basically the same with the same period last year; thick plates accounted for 549,000 tonnes, an increase of 73.19% from the corresponding period last year; and large section plant accounted for 368,000 tonnes, a decrease of 6.36% from the same period last year. Decrease of the production volume of the large section plant was mainly resulted from the stoppage of the large section plant for two months as the Company renovated it in February and March of this year. The steel smelting plant produced 1,055,000 tonnes in the first half of the year.

(2) In accordance with IAS, the Company posted profit attributable to the shareholders of Rmb197,265,000 for the six months ended 30 June 2001, representing a 12.04% decrease from the same period last year; earnings per share were Rmb0.067.

In accordance with PRC Accounting Standards, the Company recorded a net profit of Rmb196,580,000 as at 30 June, 2001 representing a decrease of 15.13% over the same period last year; earnings per share were Rmb0.067.

(3) The Company strengthened market development and kept track of market trend so as to adjust its pricing policies in time and maximize profit. By making tenders in the vessel industry and major railway and bridge projects, the Company aimed at increasing its market share. For example, the Company officially entered into a supply agreement with Shanghai Magnetically Levitated Transport Development Co., Ltd. in the first half of the year. Pursuant to which, the Company will supply 15,548 tonnes of *-shaped steel, S355N steel plates and functional plates for Shanghai "magnetically levitated" speed train project. *-shaped steel is a new type of steel which was firstly successfully developed and rolled in the PRC. It marked a new level of products of the Company. In the first half of the year, the Company sold 1,926,000 tonnes of steel products and the production to sales ratio was 99.33%.

(4) For speeding up technology progress and the development of new products, a science and technology enhancement committee has been set up. A management system covering production, sale and research has been established. The Company developed new products

and its production volume and earnings amounted to 89,000 tonnes and Rmb77 million respectively in the first half of the year.

(5) The Company strengthened its reform and enhanced the overall quality. In the first half of the year, a comprehensive central production and management system was implemented so as to enhance central co-ordination of production for strengthening the overall efficiency of production and operations. In addition, a reform on human resources and distribution was stepped up. The middle management was recruited externally. The Company also sought to implement annual salary system and salary system in relation to job responsibilities.

(6) The Company made efforts to increase the quality of products. In the first half of the year, the product quality indicator of the Company increased and the loss arising from retired and defective products and product quality disagreement substantially decreased. Economic loss decreased by Rmb24.15 million through the reduction of loss arising from the quality of steel products.

(2) Investment of the Company

1. Application of proceeds

Method of raising fund	Investment projects undertaken	Projected date of investment	Total investment Rmb0'000	Estimated returns rate %	Actual investment amount Rmb0'000	Date of actual investment
Issue of H & A shares	Construction of steel smelting plant in Anshan	1997-10-01	240,000	17.10	154,099	1997-10-01
Issue of H & A shares	Renovation of the combined pickling and continuous rolling line	1997-10-01	70,000	25.43	64,543	1997-10-01
Issue of H & A shares	Construction of galvanized steel production line	1998-01-01	149,400	15.51	592*	Unknown (investment to be made)
Issue of H & A shares	Renovation of 1,700 cold rolling cross cutting lines	1997-10-01	6,000	19.56	6,000	1997-10-01
Issue of convertible debentures	Renovation of cold rolling line	2000-12-01	195,000	13.29	9,525	2000-12-01
Issue of convertible debentures	Renovation of No. 2 and 3 cross cutting line of Cold Rolling Plant	2000-12-01	10,000	23.60	3,386	2000-12-01
Issue of convertible debentures	Distribution center for Cold Rolling Plant	2000-07-01	18,000	15.66	0	Unknown (investment to be made)

*Note: This amount represents the aggregate of the preliminary costs and expenses incurred in relation to the preparatory work for construction but is not the actual investment itself.

2. Status of unused proceeds:

The Company raised funds totalling Rmb4,113.4 million since 8 May 1997. Total proceeds used in related projects amounted to Rmb2,381.45 million. As most of the projects of the Company require a substantial period of time for construction and long term investment, the Company has therefore applied Rmb840 million proceeds from the A and H share issues and the convertible debentures for the repayment of its bank loans and loans from Angang Holding in order to reduce its financial expenses. The remaining Rmb 891.95 million were placed with banks.

3. Progress and earnings of projects:

In relation to construction of the aforementioned steel smelting plant project in Anshan, the Company has invested in certain continuous casting facilities which have commenced operation and the converter acquired by the Company from Angang Holding has also started operation. The profit amounted to Rmb 50 million in the first half of 2001. The combined pickling and continuous rolling line commenced operation and raised a profit amounting to Rmb 25 million in the first half of 2001. The renovation of 1,700 cold rolling cross cutting lines was completed, bringing a profit of Rmb4 million in the first half of 2001. The contract for the construction of galvanized steel production line was preliminarily signed and it is subject to the State's approval. Other projects are under preparation or construction.

4. Investment, progress and earnings of non-proceeds:

In order to cope with market needs, the Company will produce high-speed heavy rail for future development. The Company has been renovating the large section plant. As at 30 June 2001, Rmb165 million were invested.

(3) Financial Status Analysis

1. Major financial indicators

Prepared under IAS (unaudited)

a. Balance sheet items

	30 June 2001 <i>Rmb'000</i>	31 December 2000 <i>Rmb'000</i>	change%	Note
Total assets	10,165,745	9,487,198	7.15	
Bills receivable	1,899,765	1,323,298	43.56	(1)
Trade receivable	93,347	162,158	(42.43)	(2)
Prepayments, deposit and other receivables	95,811	119,481	(19.81)	(3)
Inventories	845,360	767,229	10.18	
Fixed assets, net	3,447,939	3,633,942	(5.12)	

Construction in progress	1,354,047	901,039	50.28	(4)
Current liabilities	2,881,847	2,014,162	43.08	(5)
Long term liabilities	35,296	253,240	(86.06)	(6)
Shareholders' funds	7,248,602	7,219,796	0.40	

b. Income statement items

	Jan-June 2001 <i>Rmb'000</i>	Jan-June 2000 <i>Rmb'000</i>	Change %	Note
Profit from principal operations	475,779	451,913	5.28	
Net profit	197,265	224,262	(12.04)	(7)

Prepared under PRC Accounting Standards (unaudited)

a. Balance sheet items

	30 June 2001 <i>Rmb'000</i>	31 December 2000 <i>Rmb'000</i>	change%	Note
Total assets	10,244,707	9,565,110	7.10	
Bills receivable	1,899,765	1,323,298	43.56	(1)
Trade receivable	93,347	162,158	(42.43)	(2)
Prepayments	339,958	276,169	23.10	
Inventories	845,360	767,229	10.18	
Fixed assets, net	3,118,862	3,301,331	(5.53)	
Construction in progress	1,354,700	895,924	51.21	(4)
Current liabilities	2,881,710	2,275,348	26.65	(5)
Long term liabilities	39,394	271,901	(85.51)	(6)
Shareholders' funds	7,323,603	7,017,861	4.36	

b. Income statement items

	Jan-June 2001 <i>Rmb'000</i>	Jan-June 2000 <i>Rmb'000</i>	Change %	Note
Profit from principal operations	474,756	462,891	2.56	
Net profit	196,580	231,618	(15.13)	(7)

2. Explanation of substantial changes in items of financial statements

(1) Increase in bills receivable was mainly attributable to an increase in sales volume of projects and receipts in advance.

- (2) Decrease of trade receivable was mainly attributable to a decrease of trade receivable for heavy rails due from China Railway Materials (Shenyang) Co. and Zhong Die Jian Shenyang Materials General Company.
- (3) Decrease in other receivables was mainly due to a decrease in tax refund for exports from Anshan State Administration of Taxation.
- (4) Increase in construction in progress was due to an increase in the amount for facilities for cold rolling lines and No.2 & 3 cutting lines under the large section plant renovation project.
- (5) Increase in current liabilities was due to an increase in the prepayment for goods given from clients.
- (6) Increase in long-term liabilities due within one year and decrease of long-term loan were due to the repayment of Rmb120 million due to Angang Holding in July since the Company went listing. The amount will all be repaid by June next year. It was transferred to the long-term liabilities due within one year.

2. Explanation of substantial changes in items of financial statements (continued)

- (7) Decrease of net profit was mainly due to a slight decrease of the product prices of the Company, decreased production volume of more profitable large section plant, due to its renovation, acquisition of steel smelting plant on 1 April 2000 increased the number of employees and increased management fee owing to increased product and technology research and development

(4) Development plan for second half of 2001

In the first half of the year, the State formulated the "Tenth Five-year Plan" for metallurgical industry. According to the plan, demand for steel products will maintain a growing trend during the period of the "Tenth Five-year Plan". It is expected that the total consumption of steel products in the PRC will reach yearly 140 million tonnes or above by 2005. The plan also pointed out that enterprises including Baogang, Angang, Wugang and Shougang should reach the advanced level of the world in terms of their product quality, technology, production facilities and labour productivity and should have certain international market share during the "Tenth Five-year Plan". It provides favourable opportunities for the long term development of the Company. However, from the recent perspective, there is still fierce competition in the steel market. A lower demand for steel in the market is expected in the second half than the first half of the year, thus bringing adverse effect on the production and operations of the Company in the second half of the year. Under these circumstances, the Company will adopt the following measures correspondingly in the second half of the year:

1. to further improve the comprehensive central management and to improve the budget management and procedural management;

2. to further strengthen market development so as to provide the Company with favourable conditions for its production and operations;
3. to further enhance internal management, make efforts to cut costs, explore corporate potential and increase efficiency;
4. to strengthen technology and quality management, development of new products and adjustment of product mix and to make the products of the Company reach a higher level by taking technology progress;
5. to further deepen reforms on labour and distribution systems, adopt annual salary and post salary systems and to improve incentive and control mechanisms; and
6. to further step up technology renovation and to implement the investment projects undertaken to be funded by proceeds as scheduled.