

# DISCUSSION AND ANALYSIS OF THE MANAGEMENT

## 1. Review of Operations

In 2001, competition in the iron and steel market of the PRC intensified and prices of steel products continued to decline. In particular, the price of one of the Company's major products, cold rolled sheets, decreased significantly. In 2001, the price of the Company's steel products slipped by 3.75% when compared to 2000, of which the price of cold rolled sheets dropped by 15.26%. As a result of these price decreases, the operations of the Company was adversely affected. In view of the situation, the Company adopted a number of measures in an effort to maintain a steady development in its production and operations.

### (i) Operating Results

In accordance with IAS, the Company recorded a net profit of Rmb366,481,000 for the year ended 31 December 2001, representing a 25.42% decrease as compared with the previous year, and basic weighted average earnings per share was Rmb0.124.

In accordance with PRC Accounting Standards, the Company recorded a net profit of Rmb403,743,000 for the year ended 31 December 2001, representing a 17.97% decrease as compared with the previous year, and weighted average earnings per share was Rmb0.137.

### (ii) Analysis of Financial and Operational Status

(In accordance with PRC Accounting Standards)

Item	2001 Rmb'000	2000 Rmb'000	Increase /(decrease) (%)	Reasons for change
Total assets	10,237,888	9,452,195	8.31	A
Long-term liabilities	419,388	271,901	54.24	B
Shareholders' fund	7,201,397	6,904,946	4.29	C
Profit from principal business	1,034,318	1,034,758	(0.04)	D
Net profit	403,743	492,204	(17.97)	E

**1. Review of Operations *(continued)***

**(ii) Analysis of Financial and Operational Status *(Continued)***

**(In accordance with IAS)**

Item	<b>2001</b> Rmb'000	2000 Rmb'000	Increase /(decrease) (%)	for change
Total assets	<b>10,244,437</b>	9,487,198	7.98	A
Long-term liabilities	<b>420,244</b>	253,240	65.95	B
Shareholders' funds	<b>7,443,542</b>	7,219,796	3.10	C
Profit from principal operations	<b>1,038,772</b>	1,013,758	2.47	D
Net profit	<b>366,481</b>	491,395	(25.42)	E

*Notes:*

- A. The increase in total assets was attributable to the profits generated by operations;
- B. The increase in long-term liabilities was due to a loan of Rmb300,000,000 from the Industrial and Commercial Bank of China; the loan of Rmb100,000,000 from the Bank of China in the year; the distribution payable to Angang Holding of Rmb120,000,000 reclassified as current liability; and decrease in debentures payable by Rmb132,513,000;
- C. The increase in shareholder's funds was attributable to the net profits generated in the year and to the conversion of convertible debentures;
- D. The profits from principal operations generally remained the same level as the previous year. In view of declining product prices in 2001, the Company maintained the profits from principal activities to generally the same level as the previous year by increasing sales and reducing costs;
- E. The decrease in net profits was mainly attributable to (i) decrease in net financial income; (ii) increase in loss arising from asset retirement; and (iii) adjustment of income tax payable and increase in income tax.

## **2. Number of Employees of the Company, Employees' Qualifications, Salary Policy and Training**

As at 31 December 2001, the Company had 9,181 employees, of whom 6,283 were involved in production, 28 were sales personnel, 555 were technicians, 60 were accounting personnel, 584 were administrative personnel. Among them, 702 had bachelor or higher degrees, representing 7.65% of the total number of the employees; 1,008 had technical diplomas, representing 10.98% of the total number of the employees; 389 had secondary education, representing 4.24% of the total number of the employees.

In the year, the Company implemented a position-related salary system and floating annual salary system for its senior management, pegging their salaries to the overall operating results of the Company as well as to their personal performance and the operating indices undertaken. A position-related salary system was implemented for production and technical staff, pegging their salaries to the relevant production and operations indicators. In addition, the salaries of sales personnel were pegged to the profits from turnover. With the aim of upgrading the service standard of the staff, the Company provided them with various types of training, including a one-week enterprise system training provided to all staff during the year; training on specialized legal knowledge; and technical training was provided to 1,276 staff members.

## **3. Impact of Tax Rate, Exchange Rate and Interest Rates**

In 2001, the tax rate applicable to the Company did not change. Exchange rate for converting Renminbi to US dollars has changed slightly. These factors did not significantly affect the financial position of the Company. In 2001, the change in interest rate did not have substantial impact on the financial position of the Company.

#### 4. Investment of the Company

##### (i) Use of Proceeds

The Company issued 890,000,000 H Shares and 300,000,000 A Shares in July 1997 and November 1997, respectively, raising a total of approximately Rmb2,633,000,000. In March 2000, the Company issued convertible debentures of Rmb1,500,000,000, raising a total of Rmb1,480,000,000, in the PRC. The proceeds were applied as follows:

Method of raising fund	Investment projects	Progress of projects undertaken	Total investment of project Rmb'000	Estimated return rate on investment or actual benefit Rmb'000	Actual investment Rmb'000	Actual progress
Issue of H & A shares	Construction of steel smelting plant	Completed in the first half of 2000	2,400,000	98,000	1,540,990	Completed in the first half of 2000
Issue of H & A shares	Renovation of the combined pickling and continuous rolling line	Completed in the first half of 2000	700,000	50,000	645,430	Completed in 2000
Issue of H & A shares	Construction by the joint venture of the galvanised steel production line	Completed in the first half of 2000	Total project investment 1,494,000 the Company's total investment 250,000	Estimated to be 15.51%	53,830	Entered into a joint venture agreement with Thyssen Krupp Stahl AG which was approved by the Ministry of Foreign Trade and Economic Cooperation. Registration for the project has been completed.
Issue of H & A shares	Renovation of the cold rolling cross cutting lines	Completed in the second half of 1999	60,000	9,000	60,000	Completed in 1998
Issue of convertible debentures	Renovation of cold rolling line	To be completed in the first half of 2003	1,950,000	Estimated to be 13.29%	608,210	Orders placed for equipment, and 85% of the equipment has been ordered
Issue of convertible debentures	Renovation of No. 2 and 3 cross Cold Rolling Plant	Completed in the second half of 2001	100,000	Estimated to be 23.60%	32,960	Completed
Issue of convertible debentures	Distribution center for Cold Rolling Plant	Completed in July 2001	180,000	Estimated to be 15.66%	—	Preliminary work is in progress

#### 4. Investment of the Company *(continued)*

##### (ii) Status of unused proceeds

As most of the projects of the Company require a substantial period of time for construction and are long term investments, the Company has therefore applied Rmb573,000,000 out of the proceeds for the repayment of its bank loans and loans from Angang Holding in order to reduce its financial expenses. The remaining Rmb599,000,000 was placed with banks.

##### (iii) Progress on uncompleted projects financed by proceeds from share and debt offerings

The joint venture between the Company and Thyssen Stahl AG to construct and operate the proposed galvanised production line was not established on schedule due to the following factors: Thyssen Stahl AG was undergoing reorganisation with Krupp when the Company was negotiating with Thyssen; the difficulty and the time required for negotiations were beyond initial expectations and the time required for submission for approval was longer than expected. At present, the Company has duly entered into a joint venture agreement with Thyssen Krupp Stahl AG and such agreement was approved by the Ministry of Foreign Trade and Economic Cooperation on 1 February 2002. On 8 February 2002, ANSC-TKS Galvanizing Co., Ltd. was jointly established with a registered capital of US\$60,000,000 with each party holding a 50% interest. The completion of the distribution center for the Cold Rolling Plant is still subject to further analysis of the implementation proposal of the project.

##### (iv) Investment, progress and earnings of working capital

- (1) The Company entered into an agreement with the Liquidation Division of Dongbeifeng on 29 August 2001, and acquired the assets of the Makoutie Phase I project of Dongbeifeng including, inter alia, a piece of land with an area of 66,422.08m<sup>2</sup>, a plant and an office building together with the relevant equipment and facilities for a consideration of Rmb50,000,000 in December 2001. At present, such facilities are not engaged in production and operation.
- (2) Projects such as the acquisition of a flattening machine and improvement of the processing line were undertaken at the Large Section Plant. The projects have been completed and the total investment was Rmb189,000,000. Moreover, an additional initial rolling machine was acquired for the Large Section Plant and the comprehensive rolling machine in the plant was improved. As at 31 December 2001, the investment was Rmb193,181,000. The flattening machine in the Thick Plate Plant was renewed and the main power supply unit in the plant was improved. As at 31 December 2001, the investment was Rmb65,691,000.

## **5. The Impact of China's Accession to the WTO on the Company's Economic Development**

The accession to the WTO will expedite the integration of the PRC economy to the global economy, and will expand the extent, the scope and the level of the Company's participation in competition and cooperation with international corporations, making it possible to utilize and to source from the domestic and overseas markets effectively. Exports of products will be expanded. On the other hand, the accession to the WTO may lead to standardization of rules and regulations and fairness in competition which have created a favourable environment and external conditions for the development of the Company. However, the abolition of import quota of steel products and the significant decrease in import tariff after the PRC's accession to the WTO will have a possible adverse effect on the domestic steel market. The oversupply situation of steel products in the domestic market is expected to worsen.

## **6. The Impact of the Official implementation of "Clause 201" on 20 March 2002 which limits Iron and Steel Imports to the U.S.**

The clause stipulated that major iron and steel products including steel products and long plates imported to the U.S. will be subject to quota limitation for three years or an additional 8%-30% tariff. Given that the steel products imported to the U.S. represented a small proportion to the total sales of the Company, the implementation of the US import restriction will not have a direct and material impact on the production and operations of the Company. For instance, total exports of the Company amounted to 106,000 tonnes in 2001, 33% of which were steel products exported to the U.S., which accounted for only 0.9% of the total sales volume of the Company in 2001.

## **7. Liquidity, Financial Resources and Capital Structure of the Company (In accordance with IAS)**

As at 31 December 2001, the Company had a long term loan of Rmb400 million, which was used for technological improvement. The term of the loan is from 3 to 5 years. The annual interest rate for the loan of Rmb300 million is 5.94% while the remaining Rmb100 million is 6.03%. As at 31 December 2001, the Company had cash and cash equivalents of Rmb761 million, which decreased by Rmb1.52 billion from Rmb2.28 billion from the previous year. It was attributable to (i) the expense of Rmb1.28 billion of technological improvement projects; (ii) increase in receipt of bill of acceptance for sales of the Company's products, leading to decrease in cash at bank and in hand.

At the end of 2001, the total assets less current liabilities of the Company amounted to Rmb7.86 billion, compared with Rmb7.47 billion at the end of 2000. The shareholders' funds of the Company amounted to Rmb7.44 billion at the end of 2001, compared with Rmb7.22 billion at the end of 2000.

## **8. Assets Pledged**

As at 31 December 2001, the Company did not pledge any assets.

## **9. Commitments and Contingent Liabilities**

As at 31 December 2001, the Company had capital commitment of Rmb4.68 billion, including US\$30 million for investment in ANSC-TKS Galvanizing Co., Ltd. and the remaining balance was for financing the construction costs of the projects.

As at 31 December 2001, the Company did not have any contingent liabilities.

## **10. Foreign currency risk**

The Company does not have any significant foreign currency risk exposure arising from its sales and raw materials purchases for production as these transactions are mainly carried out in Renminbi, with the exception of a small portion of export sales conducted in foreign currencies. The Company incurs foreign currency risks on commitments to purchase plant and equipment in currencies other than Renminbi. The Company uses foreign currency deposits to hedge against such foreign currency risks. The foreign exchange losses arising on translation of the deposits designated for hedging forecasted transactions for the year amounted to Rmb21,082,000 (2000: losses of Rmb28,142,000).

## **11. Gearing Ratio**

In accordance with IAS, the shareholders' funds to liabilities ratio of the Company in 2001 was 2.66 times, compared with 3.18 times in 2000.