V. Management Discussion and Analysis

1) Business review

The first half of 2002 has seen positive developments in the PRC economy and an increase in demand for steel products. However, in the first quarter of the year, owing to the impact of foreign steel products on domestic sales, the price of steel products, particularly the price of cold rolled sheet, was still in low level. Since 23 March this year, the Ministry of Foreign Trade and Economic Cooperation of the PRC placed a case on file for investigation on antidumping for imported steel products which are originally produced in Russia, Korea, Kazakhstan, Ukraine and Taiwan, so as to facilitate the growth of steel price in the PRC. But throughout the first half of the year, the price of the Company's products was lowered by 4.84% compared with the price in 2001 and was lowered by 6% compared with the same period last year.

In accordance with IFRS, the Company recorded a profit attributable to shareholders of Rmb194,630,000 for the six months ended 30 June 2002. Earnings per share was Rmb0.066.

In accordance with PRC Accounting Rules and Regulations, the Company recorded a net profit of Rmb190,920,000 for the six months ended 30 June 2002. Earnings per share was Rmb0.065.

To overcome the adverse market condition, the Company adopted a variety of measures to boost production and its operation:

1. The Company focused on the expansion of market for its products, the increasing of direct sale to end users, and increasing orders for products which are special, distinctive and of high quality such as its heavy rails, boiler plates, container plates , IF steel and vehicle plates. Orders for the above products increased by 127,100 tonnes over the same period of the previous year.

   The Company sold 2,122,300 tonnes of steel in the first half of 2002 and the production to sales ratio was as high as 98.67%.

2. Enhance quality of products. During the first half of the year, the Company produced 2,150,800 tonnes of steel products, representing an increase of 10.91% over the same period last year, of which cold rolled sheets accounted for 687,700 tonnes, representing an increase of 28.04% as compared with same period last year; wire rods accounted for 447,900 tonnes, representing a decrease of 7.59% over the same period last year; thick plates accounted for 520,600 tonnes, representing a decrease of 5.14% as compared with the same period last year; the Large Section Plant produced 494,600 tonnes of steel, representing an increase of 34.20% as compared with the same period last year. The Steel Smelting Plant of the Company produced 1,268,300 tonnes of steel,representing an increase of 20.14% over the same period last year. .

3. To meet market demand and to encourage technological innovation, the Company established a new project development system and a project manager responsibility system. A total of 70 technological innovation items were developed and 20 of them passed the examination. The Company focused its effort on the development of new products and technological advancement and has developed high speed heavy rail at its Large Section Plant, IF steel at its Cold Rolled Sheet Plant and wire steel at its Wire Rod Plant.

4. The Company adopted a centralised management system in relation to its steel production. Since the beginning of the year, the Company has improved the centralised management system for the Thick Plate Plant, the Steel Smelting Plant and the Large Section Plant. In June, the Company also implemented such system for its Wire Rods Plant and Cold Rolled Sheet Plant. In addition, the Company conducted research on the production and manufacturing of steel products in accordance with the requirements of Enterprise Resource Planning (ERP), which helped to improve the production procedure.

5. The Company's core products are steel products, which has an overall market share of 2.09%. The major steel products which contributed to more than 10% of the Company's income from principal operations or profit from principal operations are set out as follows (based on IFRS):

(Unit: Rmb'000)

Name of products	Sales income	Percentage to total revenue (%)	Profit from principal operations	Percentage to profit from principal operations (%)	Cost of principal operations	Gross profit margin (%)
Cold rolled sheets	1,733,087	34.58	74,405	15.36	1,658,682	4.29
Thick plates	1,123,627	22.42	66,805	13.79	1,056,822	5.95
Wire rods	791,588	15.79	22,008	4.54	769,580	2.78
Large steel products	1,208,620	24.11	310,134	64.01	898,486	25.66

2) Investment

The Company issued H shares, A shares and convertible debentures by way of listing and raised a total amount of Rmb4,113,400,000.

1. It was proposed that the proceeds shall be used in seven projects. The following four projects were completed and operation has commenced:

    (1) Establishment of a Steel Smelting Plant with a total investment of Rmb1,540,992,000;

    (2) Alterations made to the combined pickling and continuous rolling casting unit with a total investment of Rmb645,434,000;

(3) Alterations made to the 1700 casting section of the Cold Rolled Sheet Plant with a total investment of Rmb60,000,000; and

(4) Alterations made to the No.2 and No.3 casting sections of the Cold Rolled Sheet Plant with a total investment of Rmb32,960,000.

2. The following three projects were in progress:

Unit: Rmb'000

Method of fund raising	**Projects to be undertaken**	**Planned progress of projects**	**Total investment of project**	**Estimated yield rate or actual benefits**	**Actual investment amount**	**Actual progress of project**
Issue of H shares and A shares	Construction of galvanised steel production line through a jointly controlled entity	Completed in the first half of 2000	Total investment of project: 1,494,000 Total investment of the Company: 250,000	15.51% (estimate)	120,018	Ground infrastructure and steel frame of the plant completed; order placed for equipment.
Issue of convertible debentures	Alteration and expansion of the cold rolling line	To be completed in the first half of 2003	1,950,000	13.29% (estimate)	945,506	Order placed for equipment.
Issue of convertible debentures	Construction of new distribution centre for the Cold Rolled Sheet Plant	Completed in July 2001	180,000	15.66% (estimate)	—	Preliminary work in progress.

3. Status of unused proceeds

The Company has raised a total amount of Rmb4,113,400,000, of which Rmb3,344,910,000 was utilised in relevant projects. As most of the projects of the Company require substantial time for construction and are long term investments, the Company has therefore applied Rmb346,000,000 out of the proceeds for the repayment of its bank loans in order to reduce its financial expenses. The remaining Rmb422,490,000 was deposited with banks.

4. Progress on uncompleted projects financed by proceeds

The jointly controlled entity between the Company and Thyssen Stahl AG ("Thyssen") for the construction and operation of the proposed galvanised production line was not established on schedule due to the following major factors: Thyssen was undergoing reorganisation with Thyssen Krupp Stahl AG when the Company was negotiating with Thyssen the difficulty and the time required for negotiations were beyond the Company's initial expectations and the time required for submission for approval was longer than expected. Currently, the ground infrastructure and the steel frame of the plant have been completed and orders for equipment have been placed. The new distribution centre for the Cold Rolled Sheet Plant was not completed on schedule as the implementation plan for the project is subject to further analysis.

5. Investment and progress and earnings from non-publicly raised funds

Alteration project for the Large Section Plant: the planned investment for this project was Rmb689,000,000. As at 30 June 2002, Rmb579,466,000 was invested. For the renovation of the flattening machine of the Thick Plate Plant and alteration of the main power supply unit of the plant, the planned investment was Rmb350,000,000. As at 30 June 2002, Rmb81,039,000 was invested. For the No.3 galvanised steel wire rods construction project: the planned investment was Rmb390,000,000. As at 30 June 2002, Rmb11,870,000 was invested.

3) Analysis of the Company's financial position

Major financial indicators

Prepared under IFRS (unaudited)

Unit: Rmb'000

(1) Items of income statement

Items	For the six months ended 30 June 2002	2001 (restated)	Increase/ Decrease(%)	Note
Turnover	5,012,114	4,737,173	5.80	1
Profit from principal operations	484,496	475,779	1.83	2
Profit attributable to shareholders	194,630	160,003	21.64	3
Net increase of cash and cash equivalents	348,638	201,969	72.62	4

(2) Items of balance sheet

Items	At 30 June 2002	At 31 December 2001	Increase/ Decrease(%)	Note
Total assets	10,932,641	10,101,922	8.22	5
Shareholders' fund	7,267,252	7,303,742	-0.50	
Long term borrowings	712,412	417,529	70.63	6
Construction in progress	1,851,589	1,082,644	71.02	7
Inventories	984,366	904,213	8.86	8
Trade receivables	2,244,119	2,569,147	-12.65	9
Trade payables	1,788,746	1,397,474	28.00	10

Note:

1. *Increase in turnover was due to increase in sales volume;*
2. *Increase in profit from principal operations was due to increase in sales volume, increase in income from principal operations and decrease in production cost of principal operations;*
3. *Increase in profit attributable to shareholders was due to increase in profit from principal operations and decrease in income tax as a result of adjustment to intangible assets;*
4. *Net increase of cash and cash equivalents was due to increase in cash flow arising from operational activities and consolidating cash of joint venture;*
5. *Increase in total assets was due to increase in construction in progress, inventory and assets of joint venture;*

6. *Increase in long-term borrowings by Rmb300,000,000 was due to increase in loan for the alteration project of the Cold Rolled Sheet Plant;*

7. *Increase in construction in progress was due to increase in construction expenditure;*

8. *Increase in inventory was due to expansion of production and sales;*

9. *Decrease in accounts receivable (including bills receivable) was due to the fact that more clients paid cash to the Company;*

10. *Increase in accounts payable (including bills payable) was due to the increasing use of bills of exchange for bank payments.*

4) The Company's development plan for the second half of 2002

In light of the market condition both domestically and internationally and having considered the results of the Company for the first half of the year, the Board estimates that the production for the second half of the year will be 1,252,000 tonnes of steel and 2,150,900 tonnes of steel products; income will be Rmb5.3 billion.

For the second half of the year, the Company will undertake more alteration and annual maintenance projects. Using the proper management of production and facilities as a starting point, the Company will strive to realise the production target for steel and steel products. Facing the severe competition upon China's accession to the WTO, the Company's focus will continue to be the development of markets, the improvement of internal management, the implementation of the strategy of "low cost, significant difference, comprehensive integration and prompt response", the production of specialised and high quality products, the improvement of product mix and the continuous development of market competitiveness.

These measures include:

1. Continue the development of a central production and management system and improve the management of production plans from an early stage. The production process will be effectively controlled so as to satisfy customers' needs in terms of time, quantity and quality. Competitiveness will be enhanced.

2. Improve the process from the renovation of equipment to production. Newly-operated units will be utilised to increase production and efficiency. Production organisation will be improved.

3. Increase the research and production of new products. Adjustment to product mix will continue. The ratio of production of products which are special, distinctive and of high quality will increase. Technological improvements will be made.

4. Increase direct sales to end users and maintain the stability of relations with such enterprises. Special efforts will be made in relation to the automobile industry with an aim to establish long-term supply relations.

5. Actively participate in the tender of important projects and increase the Company's ability to export its products, with the aim of reaching a target of 50,000 tonnes for heavy rail products in tender projects in the year.

5) Liquidity, financial resources and capital structure of the Group (in accordance with IFRS)

As at 30 June 2002, the Group had long term bank loans of Rmb700 million, which were mainly used for technological improvement. The terms of the loans are from three to five years. The annual interest rate for the loan of Rmb300 million is 5.94% while the remaining Rmb400 million is 5.49%.

As at 30 June 2002, the Group had cash and cash equivalents and deposits with banks of Rmb1.06 billion, which increased by Rmb299 million from Rmb761 million for the previous year. It was mainly attributable to cash inflow from operating activities and cash from consolidation of jointly controlled entity.

As at 30 June 2002, the total assets less current liabilities of the Group amounted to Rmb7,980 million, compared with Rmb7,721 million at the end of 2001. The shareholders' funds of the Company amounted to Rmb7,267 million as at 30 June 2002, compared with Rmb7,304 million as at the end of 2001.

6) Assets pledged

As at 30 June 2002, the Group did not pledge any assets.

7) Commitments and contingent liabilities

As at 30 June 2002, the Group had capital commitment of Rmb4,520 million, including US15.50 million for investment in ANSC-TKS Galvanizing Co., Ltd. ("ANSC-TKS") and the remaining balance was for financing the construction costs of the projects and technology transfer fee.

As at 30 June 2002, the Group did not have any contingent liabilities.

8) 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 such foreign currency risks.

9) Gearing ratio

In accordance with IFRS, the shareholders' funds to liabilities ratio of the Group on 30 June 2002 was 1.98 times, compared with 2.61 times on 31 December 2001.