

MANAGEMENT DISCUSSION AND ANALYSIS

I. Fall in operating results due to falling steel price

In the first half of 2002, due to the robust growth in domestic production and falling prices of steel products, operating results of the Group was affected. For the six months ended 30 June 2002, the Group's turnover was Rmb1,814,817,000, representing a decrease of Rmb66,887,000 over the corresponding period; profit before taxation was Rmb91,840,000, representing a decrease of Rmb36,583,000 over the corresponding period; profit for the period was Rmb82,738,000, representing a decrease of Rmb40,947,000 over the corresponding period.

1. Gross profit was Rmb232,932,000, a decrease of approximately Rmb69,693,000 over the corresponding period.

(1) Gross profit decreased by approximately Rmb135,300,000 due to fall in steel price. Prices of steel products continued to fall since June last year. Until April this year, prices of medium-gauge steel plates and steel sections rebound. In the first half of 2002, the average selling price of steel products of the Group was Rmb2,105 per tonne, representing a decrease of Rmb172 and 7.55% as compared with the same period of last year. In particular, the average selling prices of medium-gauge steel plates, steel sections (including rolled billets), wire rods and spiral-grained steel were Rmb2,247, Rmb2,058, Rmb1,876 and Rmb1,874 per tonne respectively, representing a decrease of 6.45%, 6.84%, 5.72% and 13.56% over the same period of last year respectively.

(2) Gross profit increased by approximately Rmb9,500,000 as contributed by the growth in sales of steel products. In the first half of 2002, the Group produced steel products of 801,200 tonnes, representing an increase of 1.71% over the same period of last year. Sales volume of steel products was 786,600 tonnes, representing an increase of 4.08% over the same period of last year; in particular, sales of medium-gauge steel plates, steel sections, wire rods and spiral-grained steel, etc. were 346,200 tonnes, 281,800 tonnes, 97,800 tonnes and 60,800 tonnes respectively.

MANAGEMENT DISCUSSION AND ANALYSIS (Cont'd)

- (3) Gross profit increased by approximately 56,107,000 as a result of the reduction in costs. In the first half of 2002, the aggregate energy consumption rate per tonne was 832 kg of standard coal, representing a decrease of 53 kg of standard coal over the same period of last year, and costs were reduced by approximately Rmb13,100,000. The procurement costs for minerals decreased, and costs were reduced by approximately Rmb9,900,000. Ageing of inventories was shortened and no provision for inventories was made for the period (2001: Rmb29,823,000).
2. In order to cater for the needs of customers, we extend the delivery services to the customers' factories and led to an increase in transportation and miscellaneous expenses. This has resulted in an increase in distribution costs over the same period of last year, profit was reduced by approximately Rmb14,573,000.
3. Increase in bank loans and finance costs led to decrease in profit by approximately Rmb1,491,000. As at 30 June 2002, the Group's bank loans totalled Rmb1,020,230,000, representing a net increase of approximately Rmb16,030,000.
4. Strengthen the collection of debts, thereby shorten the ageing of accounts receivable. Provision for bad debts was reduced by approximately Rmb31,690,000 over the same period of last year. Administrative expenses also decreased over the same period of last year, thereby led to an increase in profit of approximately Rmb26,824,000.
5. Provision for impairment of fixed assets was reduced by approximately Rmb26,420,000 over the same period of last year, which led to a decrease in other expenses and thereby profit was increased by approximately Rmb22,496,000.

MANAGEMENT DISCUSSION AND ANALYSIS (Cont'd)

- 2002 is the third profitable year for the Company. Pursuant to the "Income Tax Law of the PRC Enterprises with Foreign Investment and Foreign Enterprises", the Company is entitled to 50% reduction in income tax. Moreover, pursuant to the "Circular concerning the Deductibility of Domestically Manufactured Equipment in the calculation of Corporate Income Tax for Foreign Investment Enterprises and Foreign Companies", the Company has submitted application for exemption from income tax and was subject to approval by the tax authorities. Nevertheless, income tax of Rmb12,776,000 has still been provided at the rate of 12% by the Company for the first half of 2002. Upon the approval of exemption from income tax by the tax authorities, adjustments will be made accordingly.

II. Balance of income and expenditure with sound financial position

- In the first half of 2002, the recovery rate of trade receivables of the Group was 99.76% of which 87.52% was settled by way of cash and 12.48% was settled through accounts set-off.
- In the first half of 2002, cash inflow from operating activities of the Group was Rmb209,830,000. After deductions of net cash outflow from investing activities amounted to Rmb180,953,000 and net cash outflow from financing amounted to Rmb102,685,000, bank balances and cash was reduced by Rmb73,808,000. As at 30 June 2002, the bank balances and cash of the Group was Rmb245,566,000, the entire amount of which was deposited with banks in the PRC. There is no designated deposit.
- As at 30 June 2002, the total assets of the Group amounted to Rmb4,502,623,000, total liabilities were Rmb2,247,761,000, and the gearing ratio was 49.92%. Due to increase in current liabilities, the liquidity ratio (current assets/current liabilities x 100%) was 84.77%.