# Management Discussion and Analysis

## Operating Results

For the year 2002, the Group captured the opportunities emerged from the recovery of the domestic steel market, put more efforts in marketing its products, fully utilised the production capacities of its facilities expanded its scale of production and sales network, resulting in significant growth in efficiency and further strengthened the competitiveness and profitability of the Group. For the year ended 31st December 2002, the Group's turnover amounted to Rmb4,182,430,000, profit before tax amounted to Rmb285,758,000, surged by Rmb422,401,000 and Rmb78,791,000, representing growth of 11.23% and 38.01% respectively as compared too the previous year.

### 1. Increase in revenue

For the year 2002, the Group's total revenue amounted to Rmb4,182,430,000, of which Rmb3,835,950,000 was derived from sales of steel products, representing 91.72% of the total revenue, up 12.78% over last year, and Rmb346,480,000 was derived from sales of non-steel products, such as water granulated slag, coking by-products, 鋼邊切頭 and hydroelectricity, which accounted for 8.28% of the total revenue, down 3.43% from last year.

| **Turnover** | **2002** | | **2001** | | **Annual Change for 2002 from 2001** |
|---|---|---|---|---|---|
| | *Amount (Rmb 0'000)* | *Percentage (%)* | *Amount (Rmb 0'000)* | *Percentage (%)* | *(%)* |
| Steel plates | 187,233 | 44.77 | 169,477 | 45.07 | 10.48 |
| Steel sections | 75,027 | 17.94 | 72,443 | 19.27 | 3.57 |
| Wire rods | 49,144 | 11.75 | 31,519 | 8.38 | 55.92 |
| Steel billets | 72,191 | 17.26 | 66,687 | 17.74 | 8.25 |
| Subtotal | 383,595 | 91.72 | 340,126 | 90.46 | 12.78 |
| Others | 34,648 | 8.28 | 35,877 | 9.54 | (3.43) |
| Total | 418,243 | 100.00 | 376,003 | 100.00 | 11.23 |

Sales of the Group's steel products for the year 2002 surged by Rmb434,690,000 over last year due to an increase in production and sales volume. During the year, the Group produced 1,738,300 tonnes of steel billets and 1,744,400 tonnes were sold (in the domestic market), the sales/production ratio reached 100.35%. Sales volume increased by 15.68% over last year, raising revenue by Rmb509,520,000.

| **Sales Volume** | **2002** *(0,000 tonnes)* | **2001** *(0,000 tonnes)* | **Annual growth over 2001** *(%)* | **Growth in revenue** *(Rmb 0,000)* |
|---|---|---|---|---|
| Steel plates | 77.69 | 69.43 | 11.90 | 20,163 |
| Steel sections | 34.68 | 31.79 | 9.09 | 6,609 |
| Wire rods | 25.31 | 16.47 | 53.67 | 16,884 |
| Steel billets | 36.76 | 33.11 | 11.02 | 7,296 |
| Total | 174.44 | 150.80 | 15.68 | 50,952 |

# Management Discussion and Analysis (continued)

## Operating Results (continued)

### 1. Increase in revenue (continued)

Nevertheless, the price of the Group's steel products slided since the second half of 2001 until March 2002. Although steel price started to rebound in April 2002, the average selling price of steel products for the year was nevertheless lower than that of the previous year. The average selling price of steel products was Rmb2,199/tonne, representing a decrease of Rmb57/tonne as compared to last year. After excluding the impacts of structural changes, revenue decreased by Rmb74,830,000.

| **Selling Price** | **2002** | **2001** | **Change in 2002 from 2001** | **Decrease in revenue** |
|---|---|---|---|---|
| | *(Rmb/tonne)* | *(Rmb/tonne)* | *(%)* | *(Rmb 0,000)* |
| Steel plates | 2,410 | 2,441 | (1.27) | 2,408 |
| Steel sections | 2,163 | 2,287 | (5.42) | 4,300 |
| Wire rods | 1,942 | 1,910 | 1.68 | (810) |
| Steel billets | 1,964 | 2,008 | (2.19) | 1,585 |
| Total | 2,199 | 2,256 | (2.53) | 7,483 |

For the year 2002, revenue from sales of the Group's non-steel products decreased by Rmb12,290,000 from last year, which was mainly attributable to a decline in price and production volume of coking by-products.

In 2002, the Group maintained the price level and increased sales, while at the same time continued to strengthen collection of accounts receivables by adopting such measures as "cash on delivery" and "receiving payment in advance". The recovery rate of accounts receivable for the year attained 103.27%. The Group was not only able to achieve full collection of the accounts receivables before due but also reduced the level of trade debtors, securing payments for expanding the production scale and technological renovation undertaken by the Group.

# MANAGEMENT DISCUSSION AND ANALYSIS (CONTINUED)

## Operating Results (CONTINUED)

### 2. Cost reduction

For the year 2002, the Group committed to implement the cost reduction measures which were comprehensive and involved every staff member. As a result of economies of scale, reducing energy and material consumption and strengthening cost management, cost saving of Rmb114,090,000 in aggregate was achieved.

(1) Increase productivity to reduce costs by approximately Rmb44,760,000

Upon completion of the overhaul and maintenance undertaken by the Group in the first quarter of 2002, the Group captured the opportunities arising from the recovery of the steel market and explored its potential to increase production at full speed, which were particularly demonstrated in the gradual increases in productivity during the second half of the year. The production of steel reached 1,010,000 tonnes, increased by 160,000 tonnes as compared to 850,000 tonnes produced in the first half of the year. For the year 2002, the Group produced 1,686,000 tonnes of pig iron, 1,860,000 tonnes of steel and 1,746,000 tonnes of steel products, representing a growth of 5.67%, 8.15% and 14.51% respectively as compared to the previous year. Expansion in productivity while decreasing fixed costs by Rmb44,760,000 was achieved .

(2) Save energy and material consumption to reduce costs by approximately Rmb39,970,000

For the year 2002, the Group's aggregate energy consumption rate per tonne was 819.5 kg of standard coal, a decrease of 46.5kg of standard coal as compared to the previous year. The consumption of standard coal was lowered by 86,500 tonnes, a saving of approximately Rmb24,970,000. The aggregate furnace coking rate was 553 kg/tonne of iron, slipped by 20 kg/tonne of iron as compared to the previous year. Consumption of materials for iron-smelting amounted to 1,081kg/tonne of steel, a decrease of 2kg/tonne of steel as compared to the previous year. The consumption of steel and iron was lowered by 3,720 tonnes, a saving of approximately Rmb4,100,000. The consolidated output ratio was 91.1%, representing a year-on-year increase of 0.6%. The consumption of steel billets decreased by 11,000 tonnes, a saving of approximately Rmb10,900,000.

(3) Strengthen inventory and management control to reduce costs by approximately Rmb29,360,000

For the year 2002, the Group continued to improve procurement of raw materials and consolidate its inventory control on costs. The Group adopted the tendering system in the purchase cycle to comply with the principles of "Three Fairness", "Three Comparisons" and "Three Reductions", leading to a decline in procurement costs, such as iron ores from abroad. The procurement costs were reduced by approximately Rmb12,670,000 even though the prices of coal, pig iron, alloy and electricity increased. The utilisation of inventories and backlogged spare parts and consumables were broadened, resulting in provisions for slow moving and obsolete inventories amounting to Rmb10,000,000, representing a decline of Rmb16,690,000 in the provisions as compared to last year.

# Management Discussion and Analysis *(continued)*

## Operating Results (continued)

**3. Increase in profit**

Facing the gloomy steel market and falling price of steel products in early 2002, the Group arranged for an overhaul to its major equipment on a timely basis in a bid to minimize any loss which might incur. Profit before tax amounted to Rmb91,840,000 for the first half of year. In April, there was a sign of recovery in the steel market. The Group therefore fully utilized the potential capacity of its major plants and equipment and strived to boost sales, which led to profit before tax amounted to Rmb285,758,000 for the year, representing a year-on-year increase of Rmb73,646,000.

(1) Gross profit amounted to Rmb668,190,000, resulting in a rise in profit by Rmb126,950,000 over last year.

In 2002, the Group sold 1,744,400 tonnes of steel billets, representing a year-on-year increase of 236,400 tonnes, resulting in an increase of Rmb509,520,000 in revenue and an increase of Rmb89,600,000 in gross profit. A number of measures such as economies of scale, reducing energy and material consumption and reinforcing management were adopted so that costs of sales was lowered by Rmb118,860,000. However, the fall in prices of steel products and coking by-products led to a drop in gross profit by Rmb81,520,000.

(2) Other revenues amounted to Rmb10,854,000, leading to an increase in profit by Rmb1,844,000 from last year.

(3) Other operating expenses amounted to Rmb23,260,000, representing a decrease of Rmb19,978,000 from last year. These expenses included Rmb4,520,000 provision for impairment of fixed assets and a net loss of Rmb10,330,000 in respect of disposal of obsolete fixed assets.

(4) Distribution costs amounted to Rmb125,687,000, representing an increase of Rmb37,830,000 from last year, which was mainly attributable to a rise in sales volume and transportation costs arising from the increased volumes of goods delivered to plants for settlement upon customers' request.

(5) Administrative expenses amounted to Rmb180,344,000, representing an increase of Rmb31,994,000 as compared to the previous year. This was mainly attributable to an increase in wages and other related charges.

(6) Net finance costs amounted to Rmb63,991,000, representing an increase of Rmb5,294,000 from last year. This was mainly attributable to an increase in bank loans and rates for discounted bills.

# MANAGEMENT DISCUSSION AND ANALYSIS (CONTINUED)

## Financial Position

In 2002, the Group increased collection of accounts receivable and normalized payment schedules. The Group had sufficient cash balances and improved cashflow. A sound cash position was maintained, but the liquidity ratio was relatively low.

**1. Cash inflow was larger than cash outflow; cash balance increased**

During the year ended 31st December 2002, the Group had cash inflow of Rmb5,658,800,000 and cash outflow of Rmb5,585,120,000. Cash inflow was more than cash outflow for the year with net cash inflow amounting to Rmb73,680,000 and together with the net cash inflow and the cash balances carried forward at the beginning of the year, the Company's cash and bank balances amounted to Rmb393,060,000 as at 31st December 2002.

| | **Cash inflow (Rmb 0,000)** | | | **Cash outflow (Rmb 0,000)** | |
|---|---|---|---|---|---|
| (1) | Cash from operating activities | 499,361 | (1) | Cash paid for operating activities | 434,340 |
| (2) | Disposal of fixed assets | 577 | (2) | Cash paid for investing activities | 37,918 |
| (3) | New bank loans | 65,723 | (3) | Repayment of bank loans | 63,890 |
| (4) | Interest income | 219 | (4) | Repayment of loans owing to the Holding Company | 12,040 |
| | | | (5) | Interest payments | 6,618 |
| | | | (6) | Dividend payments | 3,706 |
| Total | | 565,880 | Total | | 558,512 |

Investing activities:

(1) The Group's investment in fixed assets amounted to Rmb306,163,000. This included completion and commencement of operations of the 11-roll straightener, No.1 moulding machine production capacity expansion, the blast furnace coal blower, desulfirization and decarbonisation, the spherical furnace project, renovation project for power and transportation systems. The steel rod project commenced trial production at the end of the year.

(2) Cost incurred for the replacement of relining of blast furnace amounted to Rmb58,017,000.

(3) Investment in security amounted to Rmb5,000,000.

(4) The consideration of acquisition of Hengda's assets was Rmb428,988,000. After offseting the proceeds from the disposal of Hengda's shares of Rmb298,190,000, the net payable to the Holding Company by the Company was Rmb130,798,000. This was settled by offsetting a receivable from a fellow subsidiary of Rmb18,000,000, notes receivable endorsed of Rmb39,000,000 and cash of Rmb10,000,000. The remaining balance of Rmb63,798,000 was still outstanding.

# Management Discussion and Analysis

## Financial Position *(continued)*

**2. Cash flow accelerated; the liquidity ratio decreased**

At 31st December 2002, the Company's current assets amounted to Rmb1,654,499,000, up Rmb221,953,000 from the beginning of the year, as a result of the increase in both production and sales volumes. In 2002, the Group's current assets period (the average value of current assets * 360 days/ turnover) was 133 days, which had speeded up by 14 days as compared with 147 day of the previous year.

The Company's current assets increased, because (i) the route of Yangtze River was dammed in the first half of 2002 and the Company increased inventories of iron ore, leading to an increase of Rmb208,802,000 in raw materials; and (ii) cash and bank balances increased by Rmb73,680,000. The production scale of the Company expanded, which led to the decrease of work in progress, finished goods, spare parts and consumables and trade and other receivables by Rmb9,680,000, Rmb15,910,000, increased by Rmb9,479,000 and decreased by Rmb44,480,000 respectively.

As at 31st December 2002, the Company's current liabilities amounted to Rmb2,037,229,000. The liquidity ratio was 81.21% (current assets/current liabilities), down 3.66% as compared to the end of the previous year. The liquidity ratio was relatively low, mainly due to using short-term borrowings to finance acquisitions of long-term assets.