1. DRIVING FORCE FOR GROWTH

The significant growth of the Company's operating results for 2003 was driven by both external and internal factors. The major external factor was the global economic recovery especially the steady and rapid growth in the PRC's national economy that stimulated an upsurge in steel demand and resulted in a short supply of steel and iron products and sharp increase in the prices of steel products. The major internal factors included the smooth progress of the Company's structural adjustment scheme, increased production capacity, secured supply of raw materials and fuels, effective energy saving measures and proper marketing and sales strategies, all of which have brought about significant increases in production and sales volumes, sales income and net profit of our steel products.

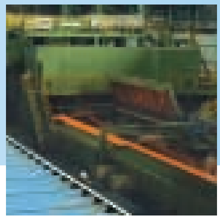
2. OPERATING ENVIRONMENT

In 2003, apparent signs of recovery were seen in the global economy. Demand in the international steel market increased and the iron and steel sector gradually recovered from its lowest ebb. The PRC government continued to expand domestic demand and implement proactive fiscal policies and prudent monetary policies that stimulated steady and rapid growth in the national economy while the exchange rate of RMB remained stable. Driven by the strong growth in industrial output, fixed assets investment and real estates investment, demand and prices of steel products both increased sharply which offered favourable development opportunities for domestic steel and iron enterprises. Nevertheless, the supply shortage, price upsurge and increased transportation costs of some major raw materials and fuels such as iron ore, coal and coke have created certain pressures on the production operation of steel and iron enterprises.

3. PRODUCTION OPERATION

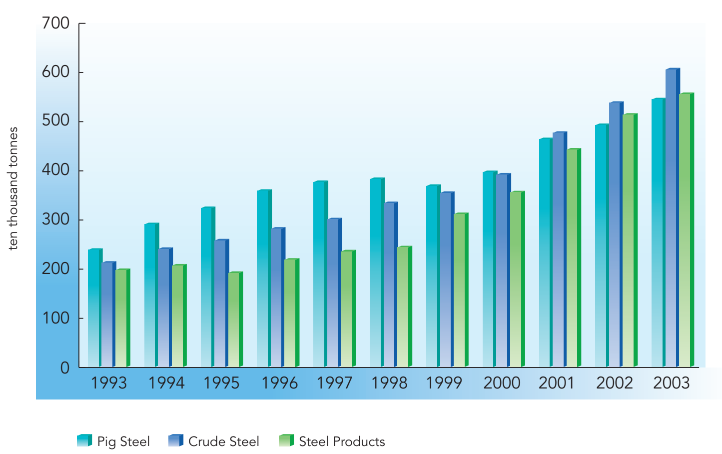
Against the pressures of price upsurge in raw materials and fuels, shortage of power supply and tight transportation, the Company made coordination in all directions and ensured long-term stable supply of resources through entering into long-term cooperation agreements with the suppliers and has created indispensable conditions for the normal production operation of the Company.

- **Substantial progress made on structural adjustment which has expanded production capacity:** Construction of the strip mill and related complementary projects was carried out as scheduled. Construction of a number of major projects such as the Revamping of High Speed Wire and Rolling Mill Project, Wire Rod Mill of No.2 Steel Making Plant, Reformation of Dock and Stock Storage Ground, the 300m^2 Sintering Machine, the 2500m^3 Blast Furnace, the No. 3 Converter of No. 1 Steel Making Plant and the Hot-rolled Thin Plate Plant have completed one after another and contributed to an increase in the Company's production capacity. As at the end of 2003, the Company recorded production capacities of pig iron, crude steel and steel products amounting to 7,250,000 tonnes, 7,640,000 tonnes and 7,370,000 tonnes respectively.



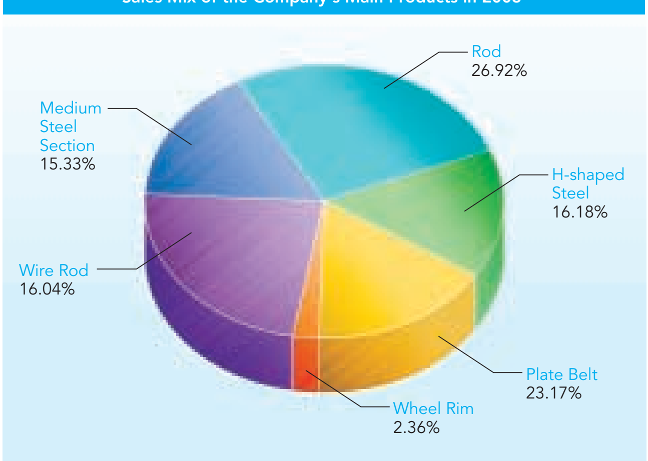
- **Economies of scale to the full extent:** By carrying forward system optimisation and logistics balance, and tapping into further equipment potentials, the Company managed to achieve better overall coordination in production operation and overcome the many difficulties in production arising from the gradual commissioning of the new projects. The Company further enhanced its production efficiency and set new records in the output of pig iron, steel and steel products. The following chart shows the Company's output of pig steel, crude steel and steel products over the years since its listing:

The Company's Output of Pig Iron, Crude Steel and Steel Products for the Years 1993 – 2003

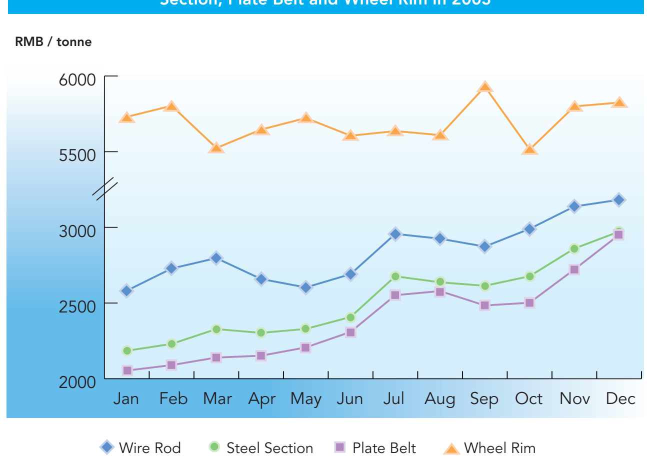


- **Capitalising on the opportunities presented in the steel market and taking solid steps to implement marketing and sales initiatives:** The Company has consolidated and developing its markets by adopting flexible pricing, effective distribution and sales promotion strategies and innovative marketing and sales tactics. Moreover, the Company has further strengthened the marketing and sales of new and high value-added products, thereby achieving synchronised growth in operation scale and efficiencies. The Group's steel products accounted for an approximately 2.2% share of the China market. The following charts show the sales mix and price trends of our four major products in 2003:

Sales Mix of the Company's Main Products in 2003



Average Sales Prices of the Company's Wire Rod, Steel Section, Plate Belt and Wheel Rim in 2003



- **The impact of technology became obvious:** By fully capitalising on the advantage of its status as a state-class technology center and by tackling technical difficulties and carrying out technology upgrade projects, the Company has strengthened its ability in technology innovations. By further tackling technical difficulties in the smooth operation of newly completed projects and in reaching their designed capacity, the Company has acquired a better mastery of the equipment's capacity for advanced processing technology. The revamping of the wire rod mill and the wire rod mill at No. 2 steel-making plant produced greater efficiencies after their commissioning. The development management system for new products underwent innovations under which an expert-in-charge system was introduced to actively promote the R&D of new products. New products developed during the year amounted to 420,000 tonnes.

In 2003, the Company showed further improvements in major technical and economic indicators through technology and equipment upgrades and process optimisation. Gross coking ratio of steel production was 408 kilograms/tonne, 4 kilograms/tonne less than that in the previous year. Consolidated consumption rate of pig iron and scrap steel was 1,088 kilograms/tonne, 5 kilograms/tonne less than that in the previous year. Consolidated energy consumption rate was reduced to 780 kilograms of standard coal for each tonne of steel produced, 26 kilograms/tonne less than that in the previous year. Consolidated continuous casting ratio was 98%, 2 percentage points higher than that in the previous year. The improved technical and economic indicators have partly offset the cost pressures resulted from the price upsurge in raw materials and fuels such as iron ore and coal, and enhanced the quality of economic operation of the Company.

In addition, stable source of funds was provided for the Company's production operation through strengthening our financial management, monitoring our income and expenses, accelerating our cash turnover and maintaining a sufficient reserve of operating cash.

4. OPERATING RESULTS AND PROFIT BREAKDOWN

As at the end of 2003, the Group's total assets were RMB26,355 million under the PRC accounting standards, up 53.78% from the corresponding period of the previous year. Such increases were mainly due to the transfer to fixed assets upon construction project completion, increase in sales volume, as well as increase in bills receivables. Shareholders' funds were RMB 14,960 million, up 23.75% due to increase in retained profits. Other operating results are as follows (in RMB million):

Item	2003	Growth over the previous year (%)
Profit from principal operating activities	3,916	135.43
Net profit	2,793	626.5
Net increase in cash and cash equivalents	1,371	605.4

The growth in profit generated from principal operating activities was mainly due to the higher growth rate of the selling prices of steel products over that of the purchasing costs of raw materials and fuels. The growth in net profit was mainly a result of increase in profit generated from principal operating activities and decrease in net non-operating expenses.

The net increase in cash and cash equivalents was mainly due to increase in cash flows generated from operating activities and financing activities. Net increase in cash inflow from operating activities was RMB979 million, representing an increase of 37.81% over the corresponding period of the previous year which was mainly due to increase in cash receipts from product sales. Net increase in cash outflow from investing activities was RMB3,244 million, representing an increase of 131.08% over the corresponding period of the previous year which was mainly due to increase in cash payments made for the purchase and construction of fixed assets. Net increase in cash inflow from financing activities was RMB3,888 million, representing an increase of 993.47% over the corresponding period of the previous year which was mainly due to increase in cash receipts from borrowings.

Changes in the Group's profit breakdown in 2003 prepared under the PRC Accounting Standards (in RMB million):

Item	**2003**	**2002**
Profit from principal operating activities	3,916	1,663
Other operating profit	63	14
Expenses for the period	(971)	(719)
Investment income/(loss)	(8)	6
Subsidies income	1	1
Net non-operating expenses	(13)	(485)
Profit before tax	2,988	480

Profit from principal operating activities accounted for 131.06% of profit before tax, a decrease of 62.17% as compared to the previous year. Such decrease was mainly due to increase in the Company's profit before tax during the reporting period;

Other operating profit accounted for 2.11% of profit before tax, a decrease of 27.71% as compared to the previous year. Such decrease was mainly due to increase in the Company's profit before tax during the reporting period;

Expenses for the period accounted for 32.53% of profit before tax, a decrease of 78.31% as compared to the previous year. Such decrease was mainly due to increase in the Company's profit before tax during the reporting period;

Investment income/(loss) accounted for 0.27% of profit before tax, a decrease of 121.42% as compared to the previous year. Such decrease was mainly due to increase in the Company's profit before tax during the reporting period;

Subsidy income accounted for 0.03% of profit before tax, a decrease of 83.94% as compared to the previous year. Such decrease was mainly due to increase in the Company's profit before tax during the reporting period;

Net non-operating expenses accounted for 0.44% of profit before tax, a decrease of 99.56% as compared to the previous year. Such decrease was mainly due to increase in profit before tax and decrease in provisions for fixed assets impairment during the reporting period.

5. STRUCTURAL ADJUSTMENT AND TECHNOLOGY UPGRADES

The Company has been implementing the structural adjustment scheme under the 10-5 Plan for almost three years. Over the past three years, the Company has never ceased to accelerate the pace of structural adjustment. A number of new production lines for products with high technology content and high added value were built while large-scale upgrade projects for existing equipment were carried out to enhance the complementary ability of our ironmaking, steelmaking and steel rolling systems and to increase capacity and improve product performance, thereby strengthening the integrated competitiveness of our products.

In 2003, the Group made use of internal resources and bank loans to invest a total of RMB6,527 million in work in progress, an increase of 208.95% over the previous year. Major investment projects were as follows:

(1) Projects which have already commenced operation:

- The Thin Plate Project, which includes the Hot-rolled Thin Plate Plant and the Cold-rolled Thin Plate Plant, with a total investment of RMB5,200 million, of which the Cold-rolled Thin Plate Plant was put into operation in March 2004;
- The Revamping of High Speed Wire and Rolling Mill Project and the Wire Rod Mill of No. 2 Steel Making Plant, investments of RMB172 million and RMB145 million respectively;
- The Reformation of Dock and Stock Storage Ground, an investment of RMB110 million;
- The 300m^2 Sintering Machine, an investment of RMB298 million;
- The 2500m^3 Blast Furnace, an investment of RMB795 million;
- The No. 3 Converter of No. 1 Steel Making Plant, an investment of RMB250 million, completed construction in October 2003;

(2) Projects under construction:

- The Modification of Train Wheel Rolling System, an investment of RMB320 million, has completed the installation of major facilities and commenced debugging tests for the same;
- Various construction projects of Coke Making Plant, of which the new No. 1 Coke Furnace, an investment of RMB172 million, completed construction in November 2003; the Coke Dry Quenching Project, an investment of RMB168 million, was put into trial run in March 2004; and the Recovery Engineering of Coke Making Plant, an investment of RMB170 million, has completed its foundation works;
- The 40000m^3 Oxygenerator, an investment of RMB340 million, commenced debugging tests in April 2004;
- The 1000m^3 Blast Furnace (originally the 850m^3 Blast Furnace), an investment of RMB225 million, has commenced installation of facilities;

- The No. 4 Converter of No. 3 Steel Making Plant, an investment of RMB212 million, has completed its foundation works and commenced hoisting of its steel framework;
- The Coil Coating Lines Project, an investment of RMB285 million, is currently preparing for installation of main facilities;
- The High-speed Rod Production Line of No. 2 Steel Making Plant, an investment of RMB208 million, is currently carrying out its foundation works.

6. FINANCIAL POSITION AND EXCHANGE RISKS

The Group's capital structure comprised mainly shareholders' equity and bank loans. As at 31 December 2003, the total amount of bank loans borrowed by the Group was RMB5,974.39 million, including loans for working capital of RMB1,919.93 million and project loans of RMB4,054.46 million. Except for three foreign currency loans in the amounts of US$229.05 million, 195.98 million Euros and 2,400 million Yen, respectively, the other loans were denominated in RMB. Movements of the Group's bank loans followed the developments in our production and construction projects. The Group had been able to repay all loans on due dates, or ahead of due dates upon consultation with the relevant banks. No overdue payments had been recorded so far.

As at 31 December 2003, in accordance with PRC Accounting Standards, the Group's total liabilities amounted to RMB11,359.46 million, shareholders' equity amounted to RMB14,960.34 million, with a gearing ratio (total liabilities/total assets) of 43.10%. Under the Hong Kong accounting standards, the Group's total liabilities amounted to RMB11,595.09 million, shareholders' equity totaled RMB14,788.02 million, with a gearing ratio (total liabilities/total assets) of 43.89%. The Group did not have any significant contingent liabilities. Other than internal resources, all capital requirements for the Group's projects during the Tenth Five-Years Plan period were financed through bank loans. As at 31 December 2003, bank commitments to provide project loans to the Group were as follows: RMB3,000 million for the Thin Plate Project; RMB117 million for the Coke Dry Quenching Project; RMB200 million for the Modification of Train Wheel Rolling System; RMB84 million for the Blast Furnace Gas Utilisation Project; RMB110 million for the Water Purification System Project; RMB57 million for the Converter Gas Recovery Project; RMB250 million for the second Galvanization Production Line; and RMB560 million for the second H-Beam Production Line.

As at 31 December 2003, the Group's cash and balances with financial institutions amounted to RMB2,418.29 million. Bills receivable amounted to RMB2,121.20 million (of which bank bills receivable due within three months amounted to RMB1,433.74 million). Pre-collection of sales payments for the coming month constituted a substantial part of the cash and balances with financial institutions and bank acceptance bills.

All loans of the Group were subject to fixed interest rates designated by the State except for loans of 179 million Euros, 2,400 million Yen and US$69.9 million.

The Group imported US$491.35 million worth of raw materials and spare parts required for production operations, while foreign exchange income generated from product exports amounting to US$87.19 million in 2003. Both our import and export operations were settled in US dollars with any amounts falling short in US dollar payment to be made up by the purchase of additional US dollars with RMB. Given that the US dollar to RMB exchange rate remained relatively stable, movements in the US dollar exchange rates did not have any significant impact on the Company's profit and loss for the period.

In 2003, the Group continued to implement its development plans in accordance with the State's 10-5 Plan – that is, Magang's structural adjustment scheme in relation to the 10-5 Plan focusing on the Company's main business, ensuring that all projects will be carried out in accordance with the Company's plans.

Increased capital expenditures were incurred from the Group's implementation of the structural adjustment scheme in accordance with the 10-5 Plan. According to the existing contracts, most imported equipment was purchased from Europe and Japan with payments to be settled in Euro and Yen. In view of lower interest rates for loans denominated in Euro and Yen, the Company borrowed 195.98 million Euros and 2,400 million Yen in bank loans for the payment of imported equipment and spare parts as at 31 December 2003. It is expected that, by the time of completion of the contracts for imported equipment, the Group will still need 23 million Euros and 1,081 million Yen for settling the payments for such imported equipment. As the exchange rates for Euro and Yen tend to be more volatile, the Group will be exposed to certain exchange risks in respect of the above loans. The Company will continue to negotiate with its banks to identify different measures for reducing exchange risks as permissible under State policies. Meanwhile, the Company is also studying and implementing various measures in relation to reducing project costs so that total expenditures will always be contained within budget limits.

7. RECENT ECONOMIC DEVELOPMENTS

In 2004, the global economy will show further recovery and that exchange rates of major currencies worldwide may continue to exhibit substantial fluctuations. Anti-dumping measures taken by various countries to protect the domestic steel industry have made the international iron and steel trading market even more complex. The PRC government continues to implement proactive fiscal policies and prudent monetary policies to exercise proper controls over the scale of fixed assets investment, and to restrain any un-planned investments and low-graded or overlapped facilities construction in certain sectors and regions, with a view to maintaining stable and faster growth in the national economy. For domestic steel enterprises, their additional production capacity will be released gradually; however, it seems quite impossible to have any obvious turnaround in the shortage situation of major raw materials fuels such as iron ore and coal in the near future.

Since the beginning of 2004, in the light of un-planned investments and low-graded and overlapped facilities construction in the PRC iron and steel sector, the relevant State departments have recently introduced a set of policies and planning guidelines on the restraint of such un-planned investments in the iron and steel sector as well as related measures of strict control over new entries into the iron and steel market. Such measures include: the State and the various local governments will not in principle approve any projects put forward by newly formed iron and steel conglomerates and independent ironmakers and steelmakers. The State will impose strict market entry conditions pursuant to which iron and steel investment projects that fail to fulfill the minimum requirements will not be approved for construction, and that external conditions in relation to iron ore, coke and water supply, and transportation, etc. must be met for a new entrant. The PBOC will not provide any loan for projects with un-planned investment, low-graded expansion, and which fail to fulfill the industrial policies and market entry conditions and have not been approved in accordance with the stipulated procedures, and appropriate steps shall be taken to rectify any loans previously provided. The relevant State departments are currently stepping up the amendments to the asset deployment policies and development plans for the iron and steel sector, encouraging improvement in the ability to supply high value-added short-supplied steel products such as plate tubes and restricting the supply of certain over-supplied, poor-quality or heavy-pollution products such as long wire rods. Such policies are aimed at reducing consumption of resources and implementing cleaner production.

The new asset deployment policies introduced by the State will help to achieve regularisation in the development of the iron and steel industry, to improve the quality of iron and steel enterprises, to prevent any disorderly or even vicious competition among iron and steel enterprises and to avoid another new round of oversupply in the iron and steel market. As a result, the new policies will be beneficial to the healthy development of the iron and steel industry and related enterprises as a whole as well as to the Company's long-term development.

8. THE COMPANY'S LONG-TERM STRATEGIES

In June 2001, the Company formulated its development plans in accordance with the State's 10-5 Plan – Magang's structural adjustment scheme in relation to the 10-5 Plan focusing on the Company's main business. Total investments amounting to approximately RMB11,720 million have been provided for. On 10 June 2003, resolutions were approved at the Company's annual general meeting to make an additional investment of RMB2,160 million for the fine-tuning of Magang's structural adjustment scheme in relation to the 10-5 Plan by adding twelve new investment projects. By implementing the revised Magang's structural adjustment scheme in relation to the 10-5 Plan, the Company's complementary production capacity of pig iron, crude steel and steel products will be further enhanced by 2005, to achieve a new product mix of "plates, shaped, wire rods and wheels" represented by four major product categories, namely thin plates, H-shaped steel, high-speed wire rods and high-speed train wheels. As a result, integrated competitiveness of our products will be strengthened, thereby improving profitability of the Company as a whole.

Given the expanding production capacity of the Company, new products being incessantly developed and produced, the wide use of computerised control system and application software, and the shorter cycle of equipment overhaul, renovation and upgrade, the originally expected useful life of fixed assets has been changed. After a re-assessment to the overall useful life of all fixed assets of the Company, the Board of Directors resolved to adjust upward the average annual depreciation rate for the Company's fixed assets from 6.5% to 8.5%. The new depreciation rate became effective on 1 January 2004 and the adjustment made for the depreciation rate of fixed assets is expected to increase the Company's depreciation charge in 2004 by RMB440 million.