

BUSINESS REVIEW

The Group achieved a net profit attributable to shareholders of HK\$67.8 million for the year ended 31 December 2003, representing a remarkable turnaround in performance when compared with a loss of HK\$295.1 million (as restated) as recorded for last year.

Throughout the year, the operating results of the Group's core businesses were on an improvement trend. The organic growth in profitability improved the Group's cashflow pattern and financial position, which were further strengthened by means of shares placement to the controlling and substantial shareholders during the year.

Manufacture and sale of steel plates

Qinhuangdao Shougang Plate Mill Co., Ltd. ("Qinhuangdao Plate Mill") reported an increase in turnover of HK\$645.9 million, from HK\$1,032.2 million in 2002 to HK\$1,678.1 million in 2003. The underlying reason for the high increase in turnover is two-folded: firstly, general demand and prices of steel products in the PRC market accelerated and remained at very high levels throughout the year; secondly, Qinhuangdao Plate Mill had taken the golden opportunity to expand its production capacity of steel plates from approximately 440,000 metric tonnes to approximately 544,000 metric tonnes to match with increasing demand during the year. In terms of its main product, Qinhuangdao Plate Mill sold approximately 505,000 metric tonnes of steel plates in 2003, representing an increase of 23.2% from approximately 410,000 metric tonnes in 2002. As Qinhuangdao Plate Mill had instituted effective measures to control costs, the growth in turnover translated into a significant increase in profitability, resulting in a turnaround of performance. For the year ended 31 December 2003, Qinhuangdao Plate Mill achieved a net profit attributable to shareholders of HK\$158.4 million, in contrast with a loss of HK\$109.6 million (as restated) for last year.

It is evidenced that the ongoing development of large-scale infrastructural projects in the PRC will continue to benefit the steel manufacturing industries. In expectation of the prolonged growth trend in the PRC steel market, we are optimistic of the performance of Qinhuangdao Plate Mill in the coming year.

Management Discussion and Analysis

Shipping operations

In our 2003 Interim Report, we pointed out that there was a constant improvement in the shipping market conditions and we expected that Shougang Concord Shipping Holdings Limited and its subsidiaries (“Shougang Shipping Group”) would improve its result in the second half of 2003. We are pleased to observe that the market trend and actual performance of Shougang Shipping Group in 2003 have coped with our expectation despite a drop in revenue income. Shougang Shipping Group reported a total operating revenue of HK\$209.2 million in 2003, a decrease of HK\$57.9 million from HK\$267.1 million in 2002. The decrease in total operating revenue was mainly due to the significant shrinkage of HK\$95.3 million in operating revenue for the voyage charter business, from HK\$159.0 million in 2002 to HK\$63.7 million in 2003. The floating crane business also recorded a fall in operating revenue by HK\$4.9 million to HK\$5.0 million. However, operating revenue for the



time charter business rose sharply by HK\$42.3 million to HK\$140.5 million, amending part of the Shougang Shipping Group’s adverse variance in operating revenue.

After a prolonged period of depression, the freight rates soared to its historical height in the fourth quarter of 2003. The Baltic Capesize index which measures freight rates of bulk vessels was approximately 2,400 points at start of the year. It gradually rose to approximately 3,000 points in August and then accelerated to around 6,900 points at the end of the year. Benefited from the strong rise in freight rates under a favourable market sentiment, the time charter business recorded only an operating loss of HK\$3.7 million in 2003, representing a tremendous decrease in loss of HK\$60.3 million when compared with the operating loss of HK\$64.0 million in 2002. The improvement in performance mainly took place in the second half year of 2003 which recorded an operating profit of HK\$6.5 million, as compared to an operating loss of HK\$10.2 million for the first half year. During the year, floating crane business performed fairly and achieved an operating profit of HK\$3.6 million, while the voyage charter business recorded a small operating loss of HK\$2.9 million. On the whole, Shougang Shipping Group incurred a loss attributable to shareholders of HK\$14.3 million for the year ended 31 December 2003, representing a decrease in loss of HK\$50.2 million from HK\$64.5 million in 2002.

After the year end, the Baltic Capesize index continued its skyward thrust to break 8,000 points and then consolidated. Market analysts in the shipping sector generally believe that the index would stay at an average level of over 4,500 points in the coming two years, which will be highly beneficial to our time charter operations. As the overall performance of our shipping operations is highly dependent on the result of the time charter business, we believe there will be a substantial performance improvement in this business segment. Barring unforeseen circumstances, we anticipate that Shougang Shipping Group will become a major profit contributor to the Group in the forthcoming year.

Management Discussion and Analysis

Electricity generation

As an integral part of the Group Reorganisation programme, the Group acquired a 51% interest in Beijing Shougang Firstlevel Power Co., Ltd. ("Beijing Power Plant") in late 2002. The performance of Beijing Power Plant for its first full year of operations since acquisition was to our satisfaction.

Beijing Power Plant achieved a turnover of HK\$374.9 million for the year ended 31 December 2003, which was mainly represented by sales of approximately 1,097 million Kwh of electricity amounting to HK\$319.3 million. Turnover in respect of



sales of steam and hot water were HK\$32.6 million and HK\$23.0 million, respectively. During the year, prices for major fuel sources including coal, coal gas, water and other ancillary materials increased and caused pressure to the costs of sales. However, through persistent efforts to control production costs Beijing Power Plant managed to achieve an operating profit of HK\$62.7 million, which has matched with our expectation.

The management will cautiously monitor the changes in costs and take possible actions to counteract any adverse impacts. The Group is confident that the electricity generation business will enjoy a steady growth in future.

Manufacture of steel cord for radial tyres; processing and trading of copper and brass products

Shougang Concord Century Holdings Limited ("Shougang Century") and its subsidiaries ("Shougang Century Group") reported another year of consecutive growth in 2003. Its remarkable performance was accomplished by an increase in turnover of HK\$62.4 million to HK\$297.3 million in 2003, a growth of 26.6% from HK\$234.9 million in 2002. Turnover for its core business of manufacture and sale of steel cord for radial tyres ("Steel Cord") increased by HK\$40.8 million to HK\$218.5 million in 2003, as a result of its successful seizure of strong demand in the steel cord market to expand production capacity by 3,000 tonnes to 13,000 tonnes during the year. Shougang Century Group has planned to further expand its annual production capacity for steel cord progressively to reach 30,000 tonnes per annum in June 2004. Turnover for the business of processing and trading of copper and brass products also grew by HK\$21.0 million to HK\$77.7 million in 2003.

The gross profit margin also showed an improvement during the year, from 32.2% in 2002 to 33.9% in 2003, which was mainly attributable to a lower cost of sales achieved by reaping economies of scale through enlarged production activities. The manufacture and sale of steel cord business is

Management Discussion and Analysis

wholly operated by the 71.8% owned subsidiary, Jiaxing Eastern Steel Cord Co., Ltd. ("Jiaxing"). In October 2003, Shougang Century Group acquired the remaining 28.2% equity interest in Jiaxing and turned it into a wholly-owned subsidiary. Shougang Century Group achieved a net profit attributable to shareholders of HK\$66.1 million for the year ended 31 December 2003, representing an increase of HK\$23.6 million from HK\$42.5 million (as restated) in 2002. The Group's share of Shougang Century Group's net profit also increased from HK\$15.5 million (as restated) in 2002 to HK\$20.9 million in 2003.



During the year, Shougang Century issued 254,208,000 new shares and raised approximately HK\$98.1 million, which was mainly used to finance the expansion in production capacity and the acquisition of aforesaid 28.2% equity interest in Jiaxing. Consequent to the said issuance of new shares, the Group's interest in Shougang Century was diluted from 36.6% to 27.4%. In accordance with generally accepted accounting principles, a deemed loss of disposal of interest in

Shougang Century in the amount of HK\$13.5 million was recognized by the Group and charged to the consolidated income statement for the year. However, there was a substantial increase of HK\$258.0 million in the market value of the Group's shareholdings in Shougang Century, from HK\$61.0 million as at 31 December 2002 (being 279,797,400 shares at HK\$0.218 per share) to HK\$319.0 million as at 31 December 2003 (being 279,797,400 shares at HK\$1.14 per share). Under the prevailing accounting practice, such capital gain had not been taken into account by the Group.

Trading of steel products; manufacture and installation of kitchen and laundry equipment

In 2003, the Group continued to consolidate its operations in these business segments and concentrated the available resources in the core businesses. Against this background, Shougang Concord Steel Holdings Limited and its subsidiaries ("Shougang Steel Group") recorded a decline in turnover of HK\$27.2 million, from HK\$90.1 million in 2002 to HK\$62.9 million in 2003. As market competition remained severe, the turnover of kitchen and laundry equipment business fell from HK\$70.2 million in 2002 to HK\$55.4 million in 2003, representing a decrease of HK\$14.8 million. Turnover of all other business divisions dropped by HK\$12.4 million to HK\$7.5 million, which was mainly due to the management decision to curtail the steel trading business.

The objective to consolidate operations in order to mitigate loss was proved correct. Shougang Steel Group recorded a loss of HK\$3.7 million in 2003, a decrease in loss of HK\$4.1 million as compared to the loss of HK\$7.8 million in 2002. During the year, the management continued to exercise tight control in costs and avoided the acceptance of loss-making orders. In future, ongoing managerial actions will be taken along this strategic direction.

NEW INVESTMENT IN STEEL BUSINESS

As mentioned in our circular dated 29 October 2003, a 51% owned subsidiary of the Group, Qinhuangdao Plate Mill entered into the agreement for investment in 24% interest in Qinhuangdao Shouqin Metal Materials Co., Ltd. ("Shouqin") for a cash consideration of RMB132.0 million. Shouqin was established to engage in the design, manufacture and sale of steel products, the related processed products and by-products. Qinhuangdao Plate Mill fulfilled its obligation by injecting the said fund within the year. It is expected that through the investment in Shouqin, the Group's strategic position in the manufacture and sale of steel products in the PRC can be enhanced and Qinhuangdao Plate Mill will be able to secure a stable supply of the scarce resources of steel slabs. Subsequent to the balance sheet date, a wholly-owned subsidiary of the Company entered into an agreement on 19 April 2004 with Shougang Corporation to acquire 27% interest in Shouqin for a cash consideration of RMB148,500,000.

LIQUIDITY AND FINANCIAL RESOURCES

The Group normally financed its operations by cash generated from its business activities and banking facilities provided by its bankers. For the year ended 31 December 2003, the Group obtained extra source of funding in respect of the subscription of 350 million ordinary shares of the Company by the controlling and substantial shareholders. The net proceeds of approximately HK\$111.9 million was mainly used to reduce the Group's debts so as to strengthen its liquidity position.

As at 31 December 2003, the Group had banking facilities of HK\$23.5 million with banking institutions in Hong Kong, and banking facilities of RMB345.0 million and US\$1.0 million with banking institutions in the PRC. These banking facilities were utilised to the extent of HK\$11.7 million, RMB235.0 million and US\$1.0 million respectively as at 31 December 2003. The banking facilities in Hong Kong were secured by certain properties of HK\$18.0 million, and those in the PRC were secured by certain plant and machinery with an aggregate net book value of RMB310.9 million, bills receivable of RMB20.0 million, cash deposit of RMB8.5 million and corporate guarantees from Shougang Corporation of RMB215.0 million.

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The Group's current assets as at the current year end amounted to HK\$709.2 million, showing an increase of HK\$76.9 million from last year end's level of HK\$632.3 million (as restated). The Group's current liabilities increased from HK\$696.1 million to HK\$740.0 million, representing a rise of HK\$43.9 million for the year. Hence, the Group's net current liabilities showed an improvement of HK\$33.0 million, from HK\$63.8 million (as restated) in 2002 to HK\$30.8 million in 2003. The Group's current ratio, defined as current assets divided by current liabilities, improved to 0.96 times as at 31 December 2003 from 0.91 times (as restated) as at last year end. Moreover, the Group's gearing ratio, defined as total debts divided by equity, decreased to 1.99 times as at 31 December 2003 from 3.45 times (as restated) as at 31 December 2002. During the year, the Group had no significant exposure to foreign exchange fluctuations and therefore no material hedging arrangements were made in this aspect.

Subsequent to the balance sheet date, the Company generated net proceeds of approximately HK\$186.1 million for the placing and subscription of its ordinary shares in March 2004. An amount of approximately HK\$140.0 million was reserved for the intended investment to expand the Group's existing steel business and the balance of approximately HK\$46.1 million was used for general working capital purposes.

CAPITAL STRUCTURE

During the year, the Company issued 350 million ordinary shares of HK\$0.20 each at a price of HK\$0.32 per share and raised net proceeds of approximately HK\$111.9 million. The event took place in November 2003, when 300 million new shares were issued to Grand Invest International Limited, a wholly-owned subsidiary of Shougang HK, and 50 million new shares were issued to Max Same Investment Limited, a wholly-owned subsidiary of Cheung Kong. As a result of the aforesaid issuance, the issued share capital of the Company was increased from HK\$459.1 million (represented by 2,295,546,454 shares) as at 31 December 2002 to HK\$529.1 million (represented by 2,645,546,454 shares) as at 31 December 2003.

Subsequent to the balance sheet date, the issued share capital of the Company was further increased due to (i) the conversion of convertible note into ordinary shares of the Company by China Gate Investments Limited ("China Gate"), a wholly-owned subsidiary of Shougang HK, (ii) placement of ordinary shares to the public by the Company, and (iii) the exercise of options granted to employees.

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In January 2004, China Gate converted the whole principal amount of the HK\$200.0 million convertible note into ordinary shares of the Company at a conversion price of HK\$0.35 per share, resulting in the issue of 571,428,571 new shares of HK\$0.20 each in the Company. In March 2004, the Company placed 300 million new shares of HK\$0.20 each to the public at a price of HK\$0.66 per share and raised net proceeds of approximately HK\$186.1 million. In the same month, certain employees of the Group exercised the granted options, pursuant to which 5 million new shares and 5.8 million new shares were issued at exercise prices of HK\$0.295 and HK\$0.410 per share, respectively.

Consequent to the aforesaid events, the issued share capital of the Company was further increased by HK\$176.5 million (represented by 882,228,571 shares) to HK\$705.6 million (represented by 3,527,775,025 shares).

CONTINGENT LIABILITIES

As at 31 December 2003, the contingent liabilities of the Group consisted of guarantees for banking facilities granted to certain third party business corporations in the PRC amounting to RMB41.8 million. In addition, the Company has provided guarantees for the due and punctual performance and observance by a wholly-owned subsidiary of the Company and each and every of its obligations, undertakings and liabilities under two time charter hires, through which the Group leases certain of its vessels. The time charter hires commenced on 26 September 1997 with a lease period of 15 years, plus two months more or less in the Group's option. The daily rates of the time charter hires increase by US\$250 every half year until December 2007, and thereafter the daily rates will increase by US\$125 every half year.

EMPLOYEES AND REMUNERATION POLICIES

The Group had a total of approximately 2,200 employees as at 31 December 2003.

The remuneration policies of the Group are to ensure the fairness and competitiveness of total remuneration in order to motivate and retain existing employees as well as to attract potential employees. Remuneration packages are structured in a way that takes into account local practices under various geographical locations in which the Group operates.

The remuneration packages of Hong Kong employees include salary payments, discretionary bonuses on a performance basis, medical subsidies and a hospitalisation scheme. All of the subsidiaries of the Group located in Hong Kong provide pension schemes for their Hong Kong employees as part of their staff benefits. The remuneration packages of certain employees in the PRC include salary payments, discretionary bonuses on a performance basis, medical subsidies and a welfare fund as part of their staff benefits.

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In addition, the Company operates a share option scheme for the purpose of providing incentives and rewards to eligible participants who contribute to the success of the Group's operations. Details of the share option scheme are set out in the Report of the Directors and note 33 to the financial statements.

PROSPECTS

The Group undertook a Group Reorganisation programme in 2002 to strengthen its assets quality and earning base. With this solid foundation, the core businesses of the Group all performed well during 2003.

As we move into 2004, we will strive to sharpen our competitive edge in our core businesses and seek opportunities to develop related businesses along our value chain. We intend to invest in the upstream businesses which are linked with resources exploration and utilisation so as to add value to our steel business. When integrated with our businesses of shipping operations and electricity generation, such new ventures will enhance the competitiveness and profitability of our value chain. This new business model will have a comparably stronger defensive power in stormy times and can seize maximized returns in good times.

The booming economy of the PRC has created business opportunities. We have a distinguished competitive advantage with the immense support of Shougang Corporation. We are facing a promising future and, barring unforeseen circumstances, we are confident that 2004 will be a rewarding year for the Group.

By order of the Board

Cao Zhong

Managing Director

Hong Kong, 19 April 2004