

## REVIEW OF OPERATIONS AND PROSPECTS

As driven by the fast-growing domestic investment in fixed assets during the first half of 2004, the economy of PRC maintained a rapid growth, while the domestic steel market also showed a strong demand with a rapid expansion in production capacity. Due to the PRC's macro-control policies, the price of steel increased and stayed at a high level. With this favourable market opportunities, the Company strived to solve the problem of shortage of raw materials and transportation, and properly adjusted its product mix to expand production and sale scales, thus achieving a desirable profitability. For the six months ended 30th June 2004, the Company's turnover amounted to Rmb4,289,239,000 and profit for the period amounted to Rmb495,999,000, an increase of 64.34% and 24.03% respectively as compared with the same period of last year.

## REVIEW OF OPERATIONS AND PROSPECTS (*COUNTINUED*)

### I. MAXIMISING THE POTENTIAL TO EXPAND PRODUCTION SCALE

During the first half of 2004, raw materials such as iron ore, coal and iron alloy experienced a shortage owing to the rapid growth in domestic steel production capacity. In response to such unfavourable conditions in raw materials procurement, the Company took effective initiatives and considerable efforts in adjusting the structure of raw materials and exploring new suppliers, thereby satisfying the production needs for raw materials. Meanwhile, maximising the potential of its existing facilities, the Company increased the capacity of blast furnace No. 3 after its overhaul. This led to a comprehensive improvement in the processes of iron smelting, steel smelting and rolling and thus a further increase in production scale. For the first half of 2004, the Company produced 567,900 tonnes of coking coal, 1,187,100 tonnes of pig iron, 1,291,000 tonnes of steel and 1,182,200 tonnes of steel products (billets), representing an increase of 13.69%, 35.27%, 31.25% and 28.49% respectively over the same period of last year, among which the growth rates of production volume of pig iron, steel and steel products were 15.01, 10.17 and 5.34 percentile higher than the domestic average growth rates respectively.

## REVIEW OF OPERATIONS AND PROSPECTS (CONTINUED)

### II. MONITORING THE MARKET TO INCREASE SALES

Facing the changing steel market conditions, the Company conducted more market research to get accurate estimation and market trends. Moreover, the Company optimised its transportation modes and improved its service quality. This minimised the impacts of various adverse factors. Meanwhile, the Company adjusted its product mix according to the market trend and put more efforts on promoting high profitable products, and secured its core customers. This increased the sales volume in industrial markets including petrochemical, electricity, shipbuilding, automobile and machinery. In the first half of 2004, the Company sold 1,172,800 tonnes of steel products (including steel billets) and the collection rate of accounts receivable was 97.30%. Sales volume of steel products (including steel billets) rose by 254,200 tonnes, representing an increase of 27.67% as compared with the same period of last year.

### III. DEVELOPING NEW PRODUCTS TO CATER FOR MARKET NEEDS

In light of its market-oriented strategy, the Company strengthened its development of product lines with good quality and high technology. In the first half of 2004, the Company developed three new products including LF390 rim steel, CG1E0921 wear-resistant lining plate and 20CrMo round steel. Trial production volume of new and specialised products amounted to 193,000 tonnes, represented an increase of 60,000 tonnes or 45.11% over the same period of last year.

## REVIEW OF OPERATIONS AND PROSPECTS (CONTINUED)

### IV. MINIMISING CLAIMS AGAINST POOR QUALITY BY STRICT CONTROLS

Due to the under-supply of raw materials in the first half of 2004, the Company's production was adversely affected by the iron ore with lower quality. In order to ensure the quality of products, the Company reinforced quality inspection and closely monitored the purchased raw materials as well as quality control on production process and key procedures. In the first half of 2004, claims against poor quality significantly decreased by 10 cases, or 11.11%, as compared with the same period of last year. The claims decreased by the amount of Rmb158,000 or 24.92% as compared with the same period of last year.

### V. IMPLEMENTING TECHNOLOGICAL RENOVATIONS TO UPGRADE THE PRODUCTION KNOW-HOW

In the first half of 2004, the Company completed one technological renovation project, namely the expansion of the continuous casting machine No.5 for steel plate slab. Since its operation, it increased the steel smelting capacity and improved the product mix and the coordination with operation of steel cutters. The Company's other projects, such as the medium plate plant's sophisticated steel cutter transformer modification and the medium plate plant's steel cutter width and capacity modification, are in progress.

## PROSPECTS

Due to the gradual effects of the PRC's macro-control initiatives, the growth of domestic investment will be slower in the second half of 2004. However, the demand of steel products will remain high due to the great demand arising from the national industrialisation and urbanisation. As such, the Company will continue to adjust its product mix in line with the changing market, and ensure steady production while maximising the potential capacity to increase production scale. Furthermore, the Company will carry out strict quality controls on purchased raw materials as well as products, and implement the technological renovations to upgrade the production know-how.