Management Discussion and Analysis

1. OPERATING ENVIRONMENT

In early 2004, the excessive growth of fixed asset investment in the PRC and the disproportionately rapid development of certain industries led to tight supply in coal, electricity and transport. In view of the situation, the government has, guided by a scientific development point of view, adopted a macro-regulatory policy of "Different Treatment for Different Sectors; Some Protected and Some Suppressed". In the latter half of the year, with the gradual implementation of various macro-economic control measures and achievement of remarkable results, the uncertain and unhealthy factors in the operation of the economy were suppressed. The momentum of the runaway growth of fixed asset investment has been curbed, evidenced by a substantial decrease in the investment and production growth rate of certain overheated industries. With the control measures in place, the national economy has seen a stable but moderately fast growth, with the annual GDP increasing by 9.5% over the previous year.

During the reporting period, the iron and steel sector had experienced excessively rapid growth before it finally came down to a state of steady development. The price of steel products had also experienced soaring followed by plunging before it finally found its reasonable level and got onto a steady track. Meanwhile, as a result of a strong demand for steel products as well as substantial increase in iron and steel production, China's iron and steel industry faced certain new difficulties. The shortages of iron ore and coal and tight supply of power and transport, coupled with upsurges in prices, have become the restraining factors in the development of the iron and steel sector.

2. DRIVING FORCE FOR GROWTH

During the reporting period, the operating results of the Company have maintained a good momentum of development. Sales income, operating profits and earnings per share have all increased significantly. Such results have benefited from the steady but moderately fast growth of the national economy of the PRC and the smooth implementation of the 10-5 Plan that has quickened the pace of structural adjustments and brought about great improvements in the variety structure of the products. As a result, the operating scale of the enterprise has advanced to a new level and there has been a substantial increase in the proportion of high value-added products.

3. PRODUCTION OPERATION

In 2004, by adhering closely to the annual production and operation objectives and implementing various measures thoroughly, the Company had maintained a desirable state of sustainable rapid growth.

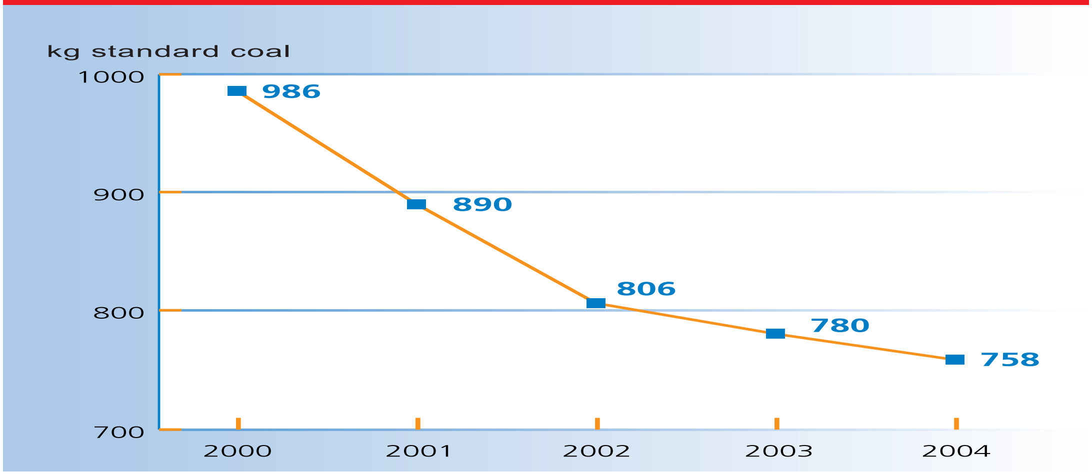
- **Cooperating with various parties to ensure supply of resources:** By entering into long-term iron ore supply contracts with international ore suppliers such as CVRD Corporation, Rio Tinto and BHP Billiton, the Company has secured the supply of iron ore and created favourable conditions for the sustainable growth of the principal iron and steel business of the Company.

- **Speeding up technological innovation and supporting efficiency enhancements with technological advancement:** The Company has been devoted to the launching of work for the digestion, absorption and innovation of new processes, new technologies and new equipment. Through a sophisticated organisation, the production capacity of new iron-making, steel-making and steel rolling projects has been enhanced quickly. With the help of advanced production lines that strengthen the development of new products, the Company has successively developed approximately 700,000 tonnes of new products such as high-grade cold upset steel, cold and hot-rolled thin plates, galvanized plates, coil-coating plates, weather-proved H-shaped steel and high quality wheels.

- **Further pursuing system optimisation to realise stable and smooth production:** As more production projects were commissioned in 2004, coordination of production and operation had seen greater difficulties. Through improving work processes, strengthening management and full implementation of "Integration of Three Standards" (a system management system that embodies ISO9000 Quality Management System, ISO14000 Environment Management System and OHSA18000 Safety Management System) and with production of cold and hot thin plates as the core, the Company has implemented system optimisation steadily, bringing about steady and smooth production particularly in respect of newly set up projects. The production volume of crude steel has achieved a record high of 8 million tones, and among steel products, the proportion of plate belts has increased by 11.55 percentage points over the previous year to 34.72%.

- **Saving energy and reducing consumption and raising the integrated utilisation level of resources:** With a view to saving energy and reducing cost, the Company has been carrying out technological reforms and updating equipment. In recent years, a batch of environmental friendly energy-saving projects such as the Coke Dry Quenching Project, Converter Gas Recovery Project and All-burning Blast Furnace Gas Boiler have been completed one after another. As they serve their respective purposes, overall energy consumption has been on the decrease and reduced to 758 kilograms of standard coal per tonne, relieving in part the pressure of higher energy prices.

The Company's Overall Energy Consumption per Tonne of Steel: 2000-2004



- **Adjusting marketing strategies flexibly and turning challenges into opportunities:** The marketing system of the Company has, in view of the remarkable rise in production capacity and the demand of the two major domestic and overseas markets, put in efforts to effect coordination, optimise channels, integrate logistics and, with respect to the change in product structure arising from the production of cold and hot-rolled thin plates and galvanized plates, established a new model of facing the end users, hence ensuring coordination between production and sales and the timely recovery of funds. The market share of the steel products of the Company in the PRC was approximately 2.7%, representing a rise of 0.5 percentage points over the previous year.

4. THE OPERATING RESULTS OF THE GROUP FOR THE REPORTING PERIOD PREPARED UNDER PRC ACCOUNTING STANDARDS ARE AS FOLLOWS:

- Analysis of principal operating income by segments and by products

  The steel segment represents 96.22% of the Group's principal operating income. The steel segment also represents 97% of the Group's profit from principal operating activities (in RMB million):

By segment/ product	Principal operating income	Cost of sales from principal operating activities	Gross profit margin (%)	Increase/ (decrease) of principal operating income as compared to the previous year (%)	Increase/ (decrease) of cost of sales from principal operating activities as compared to the previous year (%)	Increase/ (decrease) of gross profit margin as compared to the previous year (%)
Steel	25,759	20,174	21.68	73.05	81.50	-3.65
Including: connected transactions	1	0.8	20	92.86	92.47	-4.07
By product						
Plate belt	9,654	7,246	24.94	169.36	182.72	-3.54
Shaped steel	6,427	4,900	23.76	39.54	45.57	-3.16
Wire rods	8,476	6,935	18.18	49.83	59.87	-5.14
Train wheels and tyres	936	868	7.26	24.47	36.05	-7.89
Including: connected transactions	1	0.8	20	92.86	92.47	-4.07

- Geographical analysis of the Group's principal operating income (in RMB million)

Region	Percentage (%)	Principal operating income	Increase/(decrease) of principal operating income as compared to the previous year (%)
Anhui	48	12,802	187
Jiangsu	17	4,544	20
Shanghai	13	3,427	30
Zhejiang	7	1,823	49
Guangdong	5	1,302	12
Other PRC regions	7	1,972	16
Exports	3	900	20

- During the reporting period, the Group's gross profit margin of principal operating activities was 22.30%, a decrease of 3.41 percentage points as compared to the corresponding period of last year. This was mainly attributable to the lower growth rate of the selling prices of steel products as compared to that of the purchasing costs of raw materials and fuels.

5. MAJOR SUPPLIERS AND CUSTOMERS

In 2004, the Group's purchase from the five largest suppliers amounted to RMB3,612 million, accounting for 19% of the Group's total purchase amount for the year. The Group's sale to the five largest customers amounted to RMB5,395 million, representing 20% of the total sale revenue of the Group for the year. Of the above-mentioned major suppliers, the Holding is a controlling shareholder of the Company. Other than that, none of the directors, supervisors, their connected parties and other shareholders (to the knowledge of the Board of Directors holding 5% or more of the Company's shares) held any beneficial interest in the Group's five largest suppliers or customers.

6. THE OPERATION AND RESULTS OF THE GROUP's MAJOR CONTROLLING SUBSIDIARIES AND ASSOCIATES

- Ma Steel International Trade and Economic Corporation, a wholly-owned subsidiary mainly engaged in the import of machinery and raw materials and export of steel products, has a registered capital of RMB50,000,000. As at the end of the reporting period, it had total assets amounting to RMB1,109 million and recorded a net profit of RMB12 million.

- Design & Research Institute of Maanshan Iron & Steel Company Limited, in which the Company holds direct and indirect stakes of 58.96% and 7.86% respectively, is mainly engaged in planning and design of metallurgical, construction and environmental protection projects and has a registered capital of RMB12,720,000. As at the end of the reporting period, it had total assets amounted to RMB100 million and recorded a net profit of RMB19 million.

- Maanshan Iron & Steel (HK) Limited, in which the Company holds direct and indirect stakes of 80% and 20% respectively, is mainly engaged in the trading of steel and iron ores, and provision of transportation services and has a registered capital of RMB4,800,000. As at the end of the reporting period, it had total assets amounting to RMB18 million and recorded a net profit of RMB5 million.

- Anhui Masteel K. Wah New Building Materials Co., Ltd., in which the Company holds a direct stake of 70%, is mainly engaged in the production, sale and transportation of slag products and provision of related consultation services and has a registered capital of US$4,290,000. As at the end of the reporting period, it had total assets amounting to RMB67 million and recorded a net loss of RMB2 million.

- Ma Steel (Wuhu) Processing and Distribution Co., Ltd., in which the Company holds direct and indirect stakes of 70% and 30% respectively, is mainly engaged in the processing and sale of metallic products, processing of motor vehicle spare parts and sale of construction materials and chemical products and has a registered capital of RMB35,000,000. As at the end of the reporting period, it had total assets amounting to RMB349 million and recorded a net profit of RMB33 million.

- Ma Steel (Guangzhou) Processing and Distribution Co., Ltd., in which the Company holds a direct stake of 66.67%, is mainly engaged in the production, processing and sale of steel products, provision of storage, transportation and after-sales services and has a registered capital of RMB120,000,000. As at the end of the reporting period, it had total assets amounting to RMB391 million and recorded a net profit of RMB12 million.

- Anhui Masteel Holly Packing Co. Ltd., in which the Company holds a direct stake of 71%, is mainly engaged in the production, sale and agency of steel products and other product packaging materials and provision of in-place packaging services and has a registered capital of RMB30,000,000. As at the end of the reporting period, it had total assets amounting to RMB75 million and recorded a net profit of RMB10 million.

7. CHANGES IN ACCOUNTING ESTIMATES

In view of technological improvement of the iron and steel industry and the rapid replacement of technological equipment in recent years, the Board of Directors has decided to adjust the depreciation rate of the Company's fixed assets. After adjustments, the overall depreciation rate of fixed assets was raised from 6.5% to 8.5%. The new depreciation rate has been effective from 1 January 2004. The adjustment of fixed assets depreciation rate has increased the Company's depreciation costs by approximately RMB445 million for 2004.

8. OPERATING RESULTS

As at the end of 2004, the Group's total assets amounted to RMB31,461 million under the PRC accounting standards, up 19.37% from the corresponding period of the previous year. Such increase was mainly due to the increase in fixed assets investment during the reporting period. Shareholders' funds amounted to RMB17,436 million, up 16.55% from the corresponding period of the previous year. Such increase was mainly due to increase in retained profits. Profit generated from principal operating activities amounted to RMB5,769 million, up 47.33% from the corresponding period of the previous year. Such increase was mainly due to increases in selling prices and in sales of steel products. Net profit amounted to RMB3,576 million, up 28.03% from the corresponding period of the previous year. Such increase was mainly due to increase in profit generated from principal operating activities. Cash and cash equivalents decreased by RMB199 million compared to last year, mainly due to repayment of bank borrowings.

9. PROFIT BREAKDOWN

Changes in the Group's profit breakdown in 2004 prepared under the PRC Accounting Standards (in RMB million):

Item	**2004**	2003
Profit from principal operating activities	**5,769**	3,916
Other operating profit	**39**	63
Expenses for the period	**1,786**	972
Profit before tax	**4,030**	2,988

Profit from principal operating activities accounted for 143.22% of gross profit, an increase of 12.16 percentage points as compared to the previous year. Such increase was mainly due to increases in selling prices and in sales of steel products during the reporting period.

Other operating profit accounted for 0.97% of gross profit, a decrease of 1.14 percentage points as compared to the previous year. Such decrease was mainly due to increase in the Company's gross profit during the reporting period.

Expenses for the period accounted for 44.33% of gross profit, an increase of 11.81 percentage points as compared to the previous year. Such increase was mainly due to increase in the Company's transportation expenses, plant rationalisation charges and exchange losses during the reporting period.

10. INVESTMENTS

In 2004, the Group continued to implement the structural adjustment scheme under the 10-5 Plan. A number of new production lines 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. During the reporting period, the Group invested a total of RMB4,763 million in work in progress, a decrease of 27.03% from the previous year:

- **Projects which have already commenced operation** (in RMB million)

Project name	Total investment
The Thin Plate Project (including the Hot-rolled Thin Plate Plant and the Cold-rolled Thin Plate Plant which were put into operation in October 2003 and March 2004 respectively)	5,200
Coke Making Plant (including the new No.1 Coke Furnace, the Coke Dry Quenching Project and the Recovery Engineering of Coke Making Plant were put into operation in November 2003, March 2004 and July 2004 respectively)	510
The Modification of Train Wheel Rolling System	320
The 40000m³ Oxygenerator	340
The 1000m³ Blast Furnace	225
The No.4 Converter of No.3 Steel Making Plant	212
The Coil Coating Lines Project	285
The High-speed Rod Production Line of No.2 Steel Making Plant	208

- **Projects under construction** (in RMB million)

Project name	Total investment	Progress
The new No.2 Coke Furnace	215	Commenced debugging tests
The Second H-Beam Welding Production Line	930	Installation of facilities
The No.2 Galvanization Production Line	670	Commenced installation of facilities

During the reporting period, in order to provide technical support, sales support and assurance of raw materials supply for the newly operating projects, the Group conducted three external investments as follows:

(1) The Company made a contribution of RMB4 million to establish 上海大宗鋼鐵電子交易中心有限公司 jointly with 浙江物產金屬集團有限公司, 萍鄉鋼鐵有限責任公司, 中儲物流在線有限責任公司, China Construction Sixth Engineering Bureau and Yan Yu, a natural person. The company is mainly engaged in the e-trading of steel products and related complementary services. The Company holds a direct stake of 20% in the company.

(2) The Company made a contribution of RMB0.4 million to acquire a stake in 鞍山華泰乾熄焦工程技術有限公司. The company is mainly engaged in the technical consultations and development of coke dry quenching project and provision of related services. The Company holds a direct stake of 5% in the company.

(3) Ma Steel (Wuhu) Processing and Distribution Co., Ltd., a controlling subsidiary of the Company, made a contribution of RMB9.6 million to establish Ma Steel (Cihu) Processing and Distribution Co., Ltd. jointly with 安徽鑫鋼經貿發展有限公司. The company is mainly engaged in the production, processing and sale of a variety of plates, wires and sections and provision of warehousing and after-sales services for the related products. The Company holds an indirect stake of 80% in the company.

11. FINANCIAL POSITION AND EXCHANGE RISKS

The Group's capital structure comprised mainly shareholders' equity and bank loans. As at the end of 2004, the total amount of bank loans borrowed by the Group was RMB5,795.91 million, including loans for working capital of RMB1,580.92 million and project loans of RMB4,214.99 million. Except for two foreign currency loans in the amounts of US$150.32 million and 205.11 million Euros respectively, all other loans were denominated in RMB. Except for two foreign currency loans in the amounts of US$141.08 million and 203 million Euros respectively which carry interests at LIBOR plus a fixed percentage, all other loans carry interests calculated at fixed interest rates as prescribed by the State. Movements of the Group's bank loans followed the developments in our production and construction projects. The Group has been able to repay all loans on due dates, or ahead of due dates upon consultation with the relevant banks. No overdue payments have been recorded so far.

As at the end of 2004, in accordance with PRC Accounting Standards, the Group's total liabilities amounted to RMB13,949 million and shareholders' equity amounted to RMB17,436 million, with a gearing ratio (total liabilities/total assets) of 44.34%. Under the Hong Kong Accounting Standards, the Group's total liabilities amounted to RMB14,095 million and shareholders' equity totaled RMB17,025 million, with a gearing ratio (total liabilities/total assets) of 45.18%. The Group did not have any significant contingent liabilities.

Other than internal resources, all capital requirements for the Group's projects during the 10-5 Plan period were financed through bank loans. As at 31 December 2004, 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; RMB560 million for the second H-Beam Production Line; RMB491 million for the Furnance-To-Converter Project; RMB105 million for the Coil Coating Lines Project; and RMB12 million for the Information System Project.

As at 31 December 2004, the Group's cash and balances with financial institutions amounted to RMB2,181.50 million. Bills receivable amounted to RMB2,233.83 million (of which bank bills receivable due within three months amounted to RMB1,341.55 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.

In 2004, the Group imported US$619.08 million worth of raw materials and spare parts required for production operations, while foreign exchange income generated from product exports amounted to US$90.87 million. 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.

As at 31 December 2004, the Group borrowed 205.11 million Euros in bank loans for the payment of imported equipment and spare parts. As the exchange rate for Euro tends to be more volatile, such loan is subject to certain exchange risks. 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.

12. CHANGES IN THE PRODUCTION OPERATION ENVIRONMENT FOR 2005

In 2005, the world will still maintain a strong momentum of economic growth with a vigorous demand in the global steel market, whereby CVRD Corporation, Rio Tinto and BHP Billiton, all being international iron ore suppliers, have increased the selling prices for the fiscal year 2005 by 71.5% over the previous year. The PRC will continue to achieve economic growth. It is expected that, in 2005, iron ore supply and demand in China will improve as a whole as compared to 2004. While no fundamental changes will take place in the supply shortages of coal and coke, electricity and transportation, domestic demand for steel will remain strong. The Company will fully capitalise on its extensive experience in cost management and achieve greater cost effectiveness through process optimisation, timely adjustments of product structure and increased output of high value-added products, thereby offsetting the pressure upon production operation brought by the price upsurge in raw materials.

Against the rapid development of the PRC steel market and increase in iron ore fines import, in order to enhance the coordination and management of iron ore import by domestic enterprises and to rationalise and standardise the operation of the domestic iron sector, the State Business Ministry and the General Administration of Customs jointly issued an announcement on 21 February 2005 in relation to the implementation of automatic import permission administration on iron ore fines with effect from 1 March 2005. Pursuant to the announcement all enterprises engaged in iron ore fines import shall apply for automatic import permission in accordance with Measures on Goods Automatic Import Permission Administration and the relevant requirements. The customs shall carry out declaration and inspection procedures for imported iron ore fines upon production of an automatic import license issued by the issuing authority under the business department.

In addition, the Ministry of Finance and the State Taxation Administration jointly issued an announcement on 29 March 2005 in relation to the cancellation of Export VAT Refund Policy for primary steel products such as pig iron, billet and steel ingot with effect from 1 April 2005.

In the long run, the policies will enable standardisation of the domestic iron ore market, facilitate structural adjustments of the domestic steel sector, and enhance industry focus, thereby creating a more favourable market and policy environment for the development of steel enterprises including the Company.

13. THE COMPANY'S LONG-TERM STRATEGIES

The 10-5 Plan – our structural adjustment scheme, which is nearing completion – has laid a solid foundation for the Company to develop itself into a modern corporation with international competitiveness. In order to further upgrade its products and achieve comprehensive coordination of sustainable development, the Company formulated the 11-5 Plan – Magang's master plan for technological reforms and structural adjustments – by reference to the domestic and overseas economic development trends and the status of the iron and steel industry. The plan represents a significant move for Magang to make a further stride in developing itself into a modern corporation.

In November 2004, the National Development and Reform Commission issued a reply and consent to the Company's 11-5 (2006–2010) master plan for technological reforms and structural adjustments (hereinafter referred to as the "11-5 Master Plan"). The plan mainly covers the building of a production line with a capacity of 5 million tonnes for high-value-added rolled steel products in the new area adjacent to the Company's existing plant, comprising mainly one 2250mm continuous hot-rolled line, one 2130mm acid washing continuous cold-rolled line, two hot galvanisation lines, as well as the supporting iron-making and steel-making facilities and all public utilities. These production lines will mainly increase the output of such products which domestic supplies are in shortage, including high-value-added products such as hot-rolled steel products, cold-rolled steel products and galvanized plates. The products will be mainly used in automobiles, home appliances and construction industries.

With the implementation of the 11-5 Master Plan, the Company's production capacity of thin plate steel products will be further expanded by an addition of 5 million tonnes by the end of 2007, and steel plate products will constitute a core product among our steel products for the manufacturing industries. As a result, the Company's overall profitability will be enhanced, and the integrated competitiveness and the market risk resistance of our products will be significantly strengthened.