Turnover and sales volume

Major products of the Group were bearing steel and spring steel. The tables below set out the sales volume and turnover of our major product for the periods indicated:

Sales Volume

	For the six months ended 30 June			
	2005 (tonnes)	**%**	2004 (tonnes)	%
Bearing Steel	**107,797**	**93%**	67,862	68%
Spring Steel	**8,355**	**7%**	8,418	9%
Carbon Structure Steel & Gear Steel	**290**	**0%**	15,231	15%
Sub-total for Steel products	**116,442**	**100%**	91,511	92%
Pig Iron	**—**	**0%**	7,983	8%
Total	**116,442**	**100%**	99,494	100%

Turnover

	For the six months ended 30 June			
	2005		2004	
	RMB'000	**%**	RMB'000	%
Bearing Steel	**391,144**	**92%**	273,922	73%
Spring Steel	**32,211**	**8%**	34,285	9%
Carbon Structure Steel & Gear Steel	**1,061**	**0%**	53,105	14%
Sub-total for Steel products	**424,416**	**100%**	361,312	96%
Pig Iron	**—**	**0%**	16,567	4%
Total	**424,416**	**100%**	377,879	100%

The Group's turnover in the first half of 2005 increased by RMB46.5 million, or 12% to approximately RMB424.4 million (2004 corresponding period: RMB377.9 million). This increase was principally due to the increase in sales volume.

The Group's sales of steel products in the first half of 2005 increased by 24,931 tonnes, or 27% to approximately 116,442 tonnes (2004 corresponding period: 91,511 tonnes). With the self-developed technology and flexible production equipment, the Group mainly focus on producing more bearing steels which accounted for 92% of the total turnover, increased by 42.8% to approximately RMB391.1 million.

During the first half of 2005, steel prices in general started to fall due to the oversupply of generic steel products in market with the expanding domestic generic steel production capacity. This led to a decrease in our selling prices accordingly. The average unit selling price per tonne in the first half of 2005 decreased by RMB153, or 4% to RMB3,645 (2004 corresponding period: RMB3,798).

Cost of sales

The cost of sales in the first half of 2005 increased by RMB43.4 million, or 15%, to approximately RMB338.4 million (2004 corresponding period: RMB295.0 million) which is slightly higher than the increase in turnover over the same period.

The unit cost of sales in the first half of 2005 decreased by RMB60 per tonne, or 2% to RMB2,906 per tonne (2004 corresponding period: RMB2,965).

The decrease in cost of sales was mainly due to the management effort in implementing different cost saving policies for iron ore, electricity and refractory materials. During the period, we purchased iron ore from the local mines in Dengfeng and Luanchuan at prices lower than market price (RMB174 per tonne and RMB420 per tonne respectively). Furthermore, we directly imported iron ore from an Australian mine at the prevailing international market price, thereby reducing the effect of 71.5% increase in international market price effective from 1 April 2005 to 31 March 2006. We also successfully signed sole supply contract with Gongyi Refractory Factory (鞏義市節能耐火廠) ("Refractory Materials Factory") and power suppliers at reduced price. Furthermore, we have commenced to use the gas generated from the blast furnace as a by-product to generate cheaper electricity in order to further lower our production costs since January 2005. Lastly the depreciation charge per tonne in the first half of 2005 also reduced by RMB8, or 4% to RMB183 per tonne (2004 corresponding period: RMB191).

The table below shows a breakdown of our total production costs for the periods indicated:

Cost of sales

	For the six months ended 30 June			
	2005		2004	
	RMB'000	**%**	RMB'000	%
RM	**208,448**	**62%**	183,715	62%
Fuel	**67,124**	**20%**	53,814	18%
Utilities	**35,141**	**10%**	31,814	11%
Depreciation	**21,286**	**6%**	19,033	7%
Staff Cost	**6,247**	**2%**	5,697	2%
Repair	**1**	**0%**	105	0%
Others	**169**	**0%**	854	0%
	338,416	**100%**	295,032	100%

Gross profit

As a result of the factors discussed above, the gross profits in the first half of 2005 increased by RMB3.2 million, or 4% to RMB86.0 million (2004 corresponding period: RMB82.8 million).

The unit gross profit in the first half of 2005 decreased by RMB94 per tonne, or 11% to RMB739 per tonne (2004 corresponding period: RMB833 per tonne).

The Group's gross profit margin in the first half of 2005 decreased by 2% to 20% (2004 corresponding period: 22%).

Administrative costs

Administrative costs in the first half of 2005 increased by RMB1.1 million, or 14% to RMB9.2 million (2004 corresponding period: RMB8.1 million). This is mainly due to the additional audit fee incurred after listing to cope with the statutory requirement in Hong Kong.

Finance costs

Finance costs in the first half of 2005 increased by RMB1.4 million, or 14% to RMB11.2 million (2004 corresponding period: RMB9.8 million). This is mainly due to increase in interest expenses for discounting notes receivables to cope with the increasing working capital needs following the increase of production volume. The company was listed on 19 May 2005 and the listing proceeds was transferred to our PRC subsidiary in mid June 2005 after approval for share capital increment was granted by PRC government.

Profit attributable to shareholders

As a result of the factors discussed above, the profit attributable to shareholders in the first half of 2005 increased slightly to RMB63.4 million (2004 corresponding period: RMB62.9 million).

The unit net profit in the first half of 2005 was RMB544 per tonne (2004 corresponding period: RMB632 per tonne).

The Group's net profit margin in the first half of 2005 decreased by 2% to 15% (2004 corresponding period: 17%).

Key financial ratios

	Note	Six months ended 30 June 2005	Year ended 31 December 2004
Current ratio	1	**120%**	67%
Inventories turnover days	2	**61 days**	36 days
Debtor turnover days	3	**26 days**	39 days
Creditor turnover days	4	**65 days**	101 days
Interest cover	5	**7 times**	8 times
Gearing ratio	6	**36%**	96%

Note:

1 current asset/current liabilities $\times$ 100%

2 $\frac{\text{Inventories}}{\text{Cost of sales}} \times$ 181 days or 365 days

3 $\frac{\text{Trade and notes receivables}}{\text{Turnover}} \times$ 181 days or 365 days

4 $\frac{\text{Trade and notes payables}}{\text{Cost of sales}} \times$ 181 days or 365 days

5 $\frac{\text{Profit before interest and tax}}{\text{Interest}}$

6 $\frac{\text{Interest-bearing loans and other borrowings}}{\text{Equity attributable to the shareholders}} \times$ 100%

Construction in progress

Our construction in progress as at 1 January 2005 and 30 June 2005 were RMB4.7 million and RMB23.8 million, respectively, which increased by RMB19.1 million. This was mainly due to the commencement of construction for refinement of production process to attain optimum production capacity which was financed by the net proceeds from the international offering.

Cash and bank balances

The increase in cash and bank balances by approximately RMB117.9 million to RMB173.0 million as at 30 June 2005 compared to that as at 31 December 2004 was mainly due to the net proceeds from the international offering of approximately RMB251.8 million, offset by the repayment of bank loan by RMB95 million, the addition of construction in progress for refinement of production process by approximately RMB19.8 million and dividend payment of RMB31.8 million to the holding company of the Company.

Trade and notes receivables

The debtor turnover days decreased from 39 days in 2004 to 26 days for the six months period ended 30 June 2005. As at 30 June 2005, trade and notes receivables balance decreased by RMB21.7 million to RMB61.3 million. This was mainly due to the management effort on improvement of debt collection.

Inventories

The inventories turnover days increased from 36 days in 2004 to 61 days for the six months period ended 30 June 2005. As at 30 June 2005, inventories balance increased by RMB52.5 million to RMB114.2 million. This was mainly due to the increase in raw materials (imported iron ore) by RMB41.4 million following the increase of production volume which will be fully utilised in third quarter of 2005.

Trade and notes payables

The creditor turnover days decreased from 101 days in 2004 to 65 days for the six months period ended 30 June 2005. As at 30 June 2005, trade and notes payables balance decreased by RMB50.7 million to RMB122.0 million. This was mainly due to the decrease in note payable, which was used in financing the purchase payment, by RMB64.3 million.

Interest-bearing loans and other borrowings

As at 30 June 2005, the total interesting-bearing loans and other borrowings decreased by RMB72.0 million to RMB204.5 million. This was mainly due to the repayment of bank loans of RMB95 million from listing proceeds. The gearing ratio decreased from 96% in 2004 to 36% for the six months period ended 30 June 2005.

Liquidity and Capital Resources

Our working capital has been principally sourced from cash generated from operations and from long term and short term debt. We also utilise advances we receive from our customers to finance part of our working capital requirements. As at 30 June 2005, the advance from customers amounted to RMB16.6 million. We also make prepayments to our suppliers which amounted to RMB29.7 million as at 30 June 2005.

Our Phase II Production Line incurred capital expenditure of RMB528 million which are mainly financed by short term bank loans and other borrowings during 2002 and 2003. It is very common for banks in PRC to grant short term loans to their customers for financing production projects and the finance cost for short term loan will be lower than long term loan. This resulted in the increase in net current liabilities and the total debts of the Group since 2002. The situation has been significantly improved after the listing and the Group had net current assets of RMB65.1 million as at 30 June 2005 as a result of the following:

(i) the receipt of the listing net proceeds of approximately RMB251.8 million; and

(ii) cash and receivables generated from business operations.

As at 30 June 2005, we had current liabilities of RMB319.4 million, of which RMB117.4 million were interest-bearing loans and other borrowings repayable within one year, and RMB122.0 million were trade and notes payables in respect of purchase of raw materials. There was RMB87.1 million long term interest-bearing loans and other borrowings outstanding.

Foreign currency risk

Since July 2004, the Group has begun the purchase of iron ore from Stemcor (S.E.A.) Pte. Ltd, who is an independent third party, to source iron ore from an Australian mine to us until the Australian mine is being emptied and the contract is in US$, which is the major contract of the Group with foreign exchange exposure. As the US$ and RMB exchange rate is quite stable and the RMB is in a favourable trend now, no hedging is considered necessary at the moment. However, the Group will closely monitor the foreign currency risk and use necessary financial instruments for hedging purposes. Except for the trust receipt loan related to the above contract of US$2.1 million (equivalent to RMB17.4 million), all other bank loans and other borrowings are in RMB.

Security

As at 30 June 2005, the Group had an aggregate banking facilities of RMB229.9 million, consisted of long term bank loans of approximately RMB72.5 million, short term bank loans of approximately RMB117.4 million, notes payables of RMB40.0 million (secured by pledged deposit of RMB50.0 million). The Group's banking facilities are secured by:

(i) certain plant and machinery situated in Gongyi factory with a net book value of approximately RMB89.6 million as at 30 June 2005.

(ii) land use rights with a net book value of approximately RMB5.8 million as at 30 June 2005.

(iii) pledged deposits of RMB50.0 million.

(iv) pledged raw materials (imported iron ore) of RMB24.0 million.

Capital commitment and contingent liabilities

As at 30 June 2005, the Group had capital commitments of approximately HK$97.0 million for refinement of production process and development of pearlite as planned with the net proceeds from international offering of the Company.

As at 30 June 2005, there were contingent liabilities amounting to RMB223.8 million for the bills discounted or endorsed with recourse. All the cross-guarantees given to various banks for banking facilities granted to third parties were provided by us in consideration for the guarantees given by these parties for our banking facilities had been fully released after the Company's listing.

Employee and remuneration policy

As at 30 June 2005, the Group had approximately 1,700 employees, of whom 11 were management personnel. As at the same date, about 98% of our workforce had completed technical school or higher education.

The Group implemented remuneration distribution policy of linkage between duties and efficiency. The remuneration of an employee consists of a basic salary and a performance-based bonus. During the period, the staff costs of the Group amounted to RMB9.7 million (2004 corresponding period: RMB8.7 million).

USE OF PROCEEDS

Due to the actual offer price from the international offering of the Company was fixed at HK$1.48 per offer share. The net proceeds (after deducting the relevant expenses) was approximately RMB252 million, the use of proceeds plan was revised accordingly. The net proceeds had been partly utilized as at 30 June 2005 as illustrated below:

	Intended application RMB'million	**Actual application from 1 January 2005 to 30 June 2005 RMB'million**	**Unutilized balance as at 30 June 2005 RMB'million**
1) Equipment refinement	99		
a) High pressure water dephosphorylation system for steel-rolling to further improve the quality of the products		**4**	
b) Electromagnetic stirring machine to ensure the stable quality of the billets from continuous casting machine		**3**	
c) 60 tonne vacuum processing furnace to refine molten steel		**7**	
d) Upgrade of the dust-removing system to ensure the group achieved the China's environmental laws and regulations following the expansion of production volume		**8**	
Unutilized funds			**77**
Sub-total	99	**22**	**77**

	Intended application RMB'million	**Actual application from 1 January 2005 to 30 June 2005 RMB'million**	**Unutilized balance as at 30 June 2005 RMB'million**
2) Bank loan repayment to resolve the cross-guarantee commitment	95	**95**	**—**
3) Development and production of pearlite	20	**—**	**20**
4) Purchasing of raw materials and general working capital purposes	38	**38**	**—**
Total	252	**155**	**97**