Management Discussion and Analysis

FINANCIAL HIGHLIGHTS

Result Summary

	For the year ended 31 December		
	2005	2004	Change
	RMB'000	RMB'000	%
Turnover	**837,529**	783,240	7%
Gross Profit	**160,355**	156,329	3%
Profit Attributable to Shareholders	**122,141**	127,653	-4%
Gross Profit Margin	**19%**	20%	-1%
Net Profit Margin	**15%**	16%	-1%

The board of directors of the Company is pleased to announce that the audited consolidated turnover of the Group for the year 2005 was RMB837.5 million, representing an increase of 7% as compared to 2004. Audited profit attributable to shareholders of the Company was RMB122.1 million, representing a slightly decrease of 4% when compared to 2004. Audited basic earnings per share for 2005 decreased by RMB0.115 to RMB0.284 when compared to 2004. Earnings per share was based on the weighted average of 430 million shares in issue in 2005, as compared to the weighted average of 320 million shares in 2004. The directors are pleased to declare final dividend of HK$0.042 per share, totalling HK$21 million. The audited consolidated financial statements for the year ended 31 December 2005 have been reviewed by the Company's Audit Committee.

BUSINESS REVIEW

During 2005, the Group achieved satisfactory performance despite the fluctuation of steel industry in PRC. We have been able to maintain stable profit margin since the end of 2004 by taking different cost saving measures. The successful listing of the Group in Hong Kong on 19 May 2005 has greatly sped up our business development and strengthened the Group's leading position in the special steel market in PRC.

The Group have implemented a flexible product mix with an emphasis on high profit margin products. During 2005, bearing steel remained as the main income source of the Group. Its contribution to the Group's turnover increased from 82% in 2004 to 93% in 2005. When compared to 2004, the sales volume of special steel products increased by 19% to approximately 244,437 tonnes. The unit cost of sales in 2005 decreased by 6% to RMB2,770 per tonne (2004: RMB2,942).

The Group was listed in Hong Kong in May this year, raising a net proceeds of RMB252 million, out of which approximately RMB99 million and RMB95 million were intended for equipment refinement and bank loan repayment respectively. The Group repaid RMB95 million bank loans in 2005 to resolve the cross-guarantee commitment. The gearing ratio decreased from 96% as at the year end of 2004 to 28% as at the year end of 2005, reflecting the Group's improved financial position.

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Turnover and sales volume

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

Turnover

	For the year ended 31 December			
	2005		2004	
	RMB'000	**%**	RMB'000	%
Bearing Steel	**783,826**	**93%**	642,773	82%
Spring Steel	**47,384**	**6%**	69,284	9%
Carbon Structure Steel & Other Steel	**6,319**	**1%**	54,333	7%
Sub-total for Steel products	**837,529**	**100%**	766,390	98%
Pig Iron	**—**	**0%**	16,850	2%
Total	**837,529**	**100%**	783,240	100%

Sales volume

	For the year ended 31 December			
	2005		2004	
	(tonnes)	**%**	(tonnes)	%
Bearing Steel	**230,042**	**94%**	171,827	81%
Spring Steel	**12,625**	**5%**	17,559	8%
Carbon Structure Steel & Other Steel	**1,770**	**1%**	15,537	7%
Sub-total for Steel products	**244,437**	**100%**	204,923	96%
Pig Iron	**—**	**0%**	8,155	4%
Total	**244,437**	**100%**	213,078	100%

The Group's turnover in 2005 increased by RMB54.3 million, or 7%, to approximately RMB837.5 million (2004: RMB783.2 million). This increase was principally due to the increase in sales volume.

The Group's sales of steel products in 2005 increased by 39,514 tonnes, or 19%, to approximately 244,437 tonnes (2004: 204,923 tonnes). With the self-developed technology and flexible production set-up, the Group mainly focus on producing more bearing steels which accounted for 93% of the total turnover, increased by 22% to approximately RMB783.8 million (2004: RMB642.8 million).

During 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 2005 decreased by RMB250, or 7%, to RMB3,426 (2004: RMB3,676).

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Cost of sales

The cost of sales in 2005 increased by RMB50.3 million, or 8%, to approximately RMB677.2 million (2004: RMB626.9 million) which is slightly higher than the increase in turnover over the same period.

The unit cost of sales in 2005 decreased by RMB172 per tonne, or 6%, to RMB2,770 per tonne (2004: RMB2,942).

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 year, 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), 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 Material Factory ("Refractory Materials Factory") and secured power supply at reduced price. Furthermore, we have commenced to use the gas generated from the blast furnace to generate cheaper electricity in order to further lower our production costs since January 2005. Lastly, the depreciation charge per tonne in 2005 also reduced by RMB22, or 11%, to RMB172 per tonne (2004: RMB194).

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

Cost of sales

	For the year ended 31 December			
	2005		2004	
	RMB'000	**%**	RMB'000	%
Raw Materials	**417,470**	**62%**	388,595	62%
Fuel	**133,291**	**20%**	115,970	18%
Utilities	**71,912**	**10%**	68,395	11%
Depreciation	**42,101**	**6%**	41,406	7%
Staff Cost	**12,213**	**2%**	11,651	2%
Repair	**49**	**0%**	319	0%
Others	**138**	**0%**	575	0%
	677,174	**100%**	626,911	100%

Gross profit

As a result of the factors discussed above, the gross profits in 2005 increased by RMB4.0 million, or 3%, to RMB160.4 million (2004: RMB156.3 million).

The unit gross profit in 2005 decreased by RMB78 per tonne, or 11%, to RMB656 per tonne (2004: RMB734 per tonne).

The Group's gross profit margin in 2005 decreased by 1% to 19% (2004: 20%).

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Administrative costs

Administrative costs in 2005 increased by RMB7.3 million, or 44%, to RMB24.0 million (2004: RMB16.7 million). This is mainly due to the increase in additional staff cost and professional fee of RMB4.2 million and RMB2.7 million respectively incurred after listing to cope with the statutory requirement in Hong Kong.

Finance costs

Finance costs in 2005 increased by RMB2.6 million, or 13%, to RMB22.6 million (2004: RMB20.0 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, but the listing proceeds was not finally transferred to our PRC subsidiary until mid of June 2005 after proper approval for share capital increment is granted by PRC government.

Profit attributable to shareholders

As a result of the factors discussed above, the profit attributable to shareholders in 2005 decreased by RMB5.5 million, or 4%, to RMB122.1 million (2004: RMB127.6 million).

The unit net profit in 2005 decreased by RMB99 per tonne, or 17% to RMB500 per tonne (2004: RMB599 per tonne).

The Group's net profit margin in 2005 decreased by 1% to 15% (2004: 16%).

Key financial ratios

		For the year ended 31 December	
	Note	**2005**	2004
Current ratio	1	**89%**	67%
Inventories turnover days	2	**54 days**	36 days
Debtor turnover days	3	**38 days**	39 days
Creditor turnover days	4	**156 days**	101 days
Interest cover	5	**7 times**	8 times
Gearing ratio	6	**28%**	96%

Note:

1 current asset/current liabilities X 100%

2 $\frac{\text{Inventories}}{\text{Cost of sales}}$ X 365 days

3 $\frac{\text{Trade and notes receivables}}{\text{Turnover}}$ X 365 days

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

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

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

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Construction in progress

Our construction in progress as at 1 January 2005 and 31 December 2005 were RMB4.7 million and RMB119.0 million, respectively, which increased by RMB114.3 million or 24 times. This was mainly due to the commencement of construction for refinement of production process to attain optimum production capacity which was mainly financed by the net proceeds from the international offering.

Cash and bank balances

The increase in cash and bank balances by approximately RMB113.3 million, or 2 times, to RMB168.4 million as at 31 December 2005 compared to that as at 31 December 2004 was mainly due to the net proceeds from the international offering of approximately RMB251.7 million and cash inflow generated from operation, offset by the repayment of bank loan by RMB95 million, the addition of construction in progress for refinement of production process by approximately RMB114.3 million and dividend payment of RMB47.4 million to the shareholders of the Company.

Trade and notes receivables

The debtor turnover days decreased from 39 days in 2004 to 38 days in 2005. As at 31 December 2005, trade and notes receivables balance increased by RMB4.3 million, or 5%, to RMB87.3 million. This was mainly due to the increase of production volume and the management effort to maintain the good debt collection records.

Inventories

The inventories turnover days increased from 36 days in 2004 to 54 days in 2005. As at 31 December 2005, inventories balance increased by RMB39.2 million, or 63%, to RMB100.9 million. This was mainly due to the increase in work in progress, finished goods and spare parts by RMB8.3 million, RMB21.1 million and RMB7.7 million respectively following the continuing increase of production volume in future.

Prepayments, deposits and other receivables

As at 31 December 2005, prepayment, deposit and other receivables balance increased by RMB73.4 million, or 2.5 times, to RMB103.0 million. This was mainly due to the increase in prepayment to suppliers of RMB65.0 million for purchase of raw materials to cope with increasing production requirement.

Trade and notes payables

The creditor turnover days increased from 101 days in 2004 to 156 days in 2005. As at 31 December 2005, trade and notes payables balance increased by RMB115.8 million, or 67%, to RMB288.6 million. This was mainly due to the increase in financing the purchase payment by notes payables by RMB98.6 million.

Interest-bearing loans and other borrowings

As at 31 December 2005, the total interest-bearing loans and other borrowings balance decreased by RMB104.0 million, or 38%, to RMB172.4 million. This was mainly due to the repayment of bank loans of RMB95 million from the listing proceeds. The gearing ratio decreased from 96% in 2004 to 28% in 2005.

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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 31 December 2005, the advance from customers amounted to RMB7.0 million. We also make prepayments to our suppliers which amounted to RMB87.9 million as at 31 December 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 liabilities of RMB54.2 million as at 31 December 2005 as a result of the following:

(i) the receipt of the listing net proceeds of approximately RMB251.7 million;

(ii) construction in progress incurred of approximately RMB119.0 million due to equipment refinement project;.

(iii) previous year long term loan become short term loan in 2005 of approximately RMB84.0 million;

(iv) repayment of bank loans of approximately RMB95 million from listing proceeds to release contingent liabilities from third parties guarantee; and

(v) cash and receivables generated from business operations.

As at 31 December 2005, we had current liabilities of RMB513.8 million, of which RMB172.4 million were interest-bearing loans repayable within one year, and RMB288.6 million were trade and notes payables in respect of purchase of raw materials.

Foreign currency risk

Since 2004, the Group has begun the purchase of iron ore from overseas suppliers. Since the contracts are in US$ and 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 consider to use necessary financial instruments for hedging purposes. Except for the trust receipt loan related to the above contract of US$0.9 million (equivalent to RMB7.4 million), all other bank loans are in RMB.

Security

As at 31 December 2005, the Group had an aggregate banking facilities of RMB375.3 million, consisted of short-term bank loans of approximately RMB172.4 million, notes payables of RMB202.9 million (secured by pledged deposit of RMB153.2 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 RMB416.6 million as at 31 December 2005.

(ii) land use rights with a net book value of approximately RMB5.4 million as at 31 December 2005.

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(iii) pledged deposits of RMB153.2 million.

(iv) pledged raw materials (imported iron ore) of RMB8.6 million.

Capital commitment and contingent liabilities

As at 31 December 2005, the Group had capital commitments in the amount of approximately RMB24.2 million for remaining parts of equipment refinement project.

As at 31 December 2005, there were contingent liabilities amounting to RMB147.9 million for the bills discounted or endorsed with recourse. All the cross-guarantees given by the Group to various banks for banking facilities granted to third parties in consideration for the guarantees given by such third parties for our banking facilities had been fully released after the Company's listing.

Employee and remuneration policy

As at 31 December 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 policy of linkage between duties and efficiency. The remuneration of employee consists of a basic salary and a performance-based bonus. In 2005, the staff costs of the Group amounted to RMB23.2 million (2004: RMB16.4 million).