

PROSPECTS

In the second half of 2006, the imbalance of supply and demand of steel products will persist and the price of steel products will remain at a low level albeit China's economy will continue to grow steadily and rapidly. As a result, the Company will face the pressure of profit decrease. As such, the Company will carry out activities of the "Implementation Year", strengthen management and achieve a scale of mass production. The product structure will be adjusted to expand the market share of profitable products. The Company will further enhance the management of purchase of raw ancillary materials to optimize the resource allocation and lower the purchase cost. Meanwhile, the Company will enhance new products development and increase the output of profitable products.

MANAGEMENT DISCUSSION AND ANALYSIS

In face of the austere steel market environment in the first half of 2006, the Company proactively adjusted its marketing strategies to promote and increase sales and production as well as reduce consumption and costs. However, due to the considerable decrease in steel prices, the Company's profit decreased. For the six months ended 30th June 2006, the Company recorded a turnover of RMB4,420,430,000, a decrease of 6.05% over the same period last year. Profit before taxation amounted to RMB35,040,000, a decrease of 92.42% over the same period last year.



MANAGEMENT DISCUSSION AND ANALYSIS (CONTINUED)

I. SALES

In the first half of 2006, the Company's turnover amounted to RMB4,420,430,000, of which RMB4,172,700,000 was derived from sales of steel products, representing 94.40% of the total revenue, with a decrease of 6.32% over the same period of last year, and RMB247,730,000 was derived from sales of non-steel products, such as water granulated slag, coking by-products, cutting steel leftover and provision of utilities including water and electricity, which accounted for 5.60% of the total revenue, with a decrease of 1.31% over the same period of last year.

Turnover	First half of 2006		As compared with the first half of 2005		
	Amount	Percentage	First half of 2005	Amount	Increase (+) / decrease (-)
	RMB0'000	(%)	RMB0'000	Percentage	(%)
Steel plates	197,610	44.70	240,837	51.18	-17.95
Steel sections	112,374	25.42	84,149	17.88	33.54
Wire rods	51,122	11.56	50,276	10.68	1.68
Steel billets	43,001	9.73	62,939	13.38	-31.68
Cold rolled thin plates	13,163	2.98	7,226	1.54	82.15
Sub-total	417,270	94.40	445,427	94.67	-6.32
Others	24,773	5.60	25,102	5.33	-1.31
Total	442,043	100.00	470,529	100.00	-6.05



MANAGEMENT DISCUSSION AND ANALYSIS (CONTINUED)

I. SALES (CONTINUED)

In the first half of 2006, sales revenue of the Company's steel products (billets) decreased by RMB281,570,000 as compared with the same period of last year, which was attributable to a rise in production and sales volume partially offset by a decline in selling prices. On the one hand, the Company sold 1,380,400 tonnes of steel products (billets) during the first half year, with an increase of 18.12% over the same period last year, which increased sales revenue by RMB807,170,000; on the other hand, the average selling price of steel products (billets) was RMB3,023 per tonne, with a decrease of 20.68% from the same period of last year, which leads to the decrease of sales revenue by RMB1,088,740,000.

Sales volume	First half of 2006 (0'000 tonnes)	First half of 2005 (0'000 tonnes)	As compared with the first half of 2005	
			(Increase) (+) / (decrease) (-) (%)	Contribution in revenue (RMB0'000)
Steel plates	62.12	54.98	12.98	31,273
Steel sections	38.73	25.30	53.08	44,669
Wire rods	18.13	15.91	13.94	7,015
Steel billets	15.50	19.17	-19.11	-12,049
Cold rolled thin plates	3.56	1.51	135.79	9,809
Total	<u>138.04</u>	<u>116.87</u>	<u>18.12</u>	<u>80,717</u>

MANAGEMENT DISCUSSION AND ANALYSIS (CONTINUED)

I. SALES (CONTINUED)

Selling price	First half of 2006 (RMB / tonne)	First half of 2005 (RMB / tonne)	As compared with the first half of 2005	
			(Increase) (+) / (decrease) (-) (%)	Contribution in revenue (RMB0'000)
Steel plates	3,181	4,380	-27.38	-74,528
Steel sections	2,902	3,326	-12.77	-16,422
Wire rods	2,820	3,160	-10.76	-6,164
Steel billets	2,774	3,283	-15.53	-7,890
Cold rolled thin plates	3,698	4,785	-22.75	-3,870
Total	<u>3,023</u>	<u>3,811</u>	<u>-20.68</u>	<u>-108,874</u>



MANAGEMENT DISCUSSION AND ANALYSIS (CONTINUED)

2. PROFITABILITY

The Company's profit before taxation for the first half of 2006 decreased by RMB427,180,000 amounting to RMB35,040,000 as compared with the same period of last year, of which:

- (1) Gross profit amounted to RMB301,690,000, representing a decrease of RMB422,240,000 over the same period of last year, mainly due to the decline in the prices of steel products.

During the first half of 2006, the average selling price of the Company's steel products (billets) decreased by 20.68% amounting to RMB3,023 per tonne as compared with the same period last year, which resulted in a decrease of RMB1,088,740,000 in profit. With more efforts in promoting and increasing sales and production, reducing consumption and costs, and optimising resource structure, the Company's profit increased by approximately RMB666,500,000 in aggregate, which failed to offset the impact of the considerably decreased prices of steel products. As such, total gross profit decreased by 58.33% over the same period last year and consolidated gross profit margin decreased from 15.38% in the same period last year to 6.82% this period.



MANAGEMENT DISCUSSION AND ANALYSIS (CONTINUED)

2. PROFITABILITY (CONTINUED)

- (2) Other gains amounted to RMB14,660,000, representing an increase of RMB31,260,000 compared with the same period last year. This was mainly attributable to retirement of certain fixed assets resulting from the technological improvements in the first half of 2005.
- (3) Sales and marketing costs amounted to RMB85,020,000, representing an increase of RMB13,890,000 as compared with the same period of last year, which was mainly attributable to an increase in shipbuilding inspection expenses as a result of the expanded sales volume of ship plates.
- (4) Administrative expenses amounted to RMB99,850,000, representing a decrease of RMB23,690,000 as compared with the same period of last year. This was mainly attributable to the decreased surcharges such as wages and social insurance.
- (5) Finance costs amounted to RMB96,430,000, representing an increase of RMB45,990,000 as compared with the same period of last year, which was mainly attributable to an increase in interest on loans.



MANAGEMENT DISCUSSION AND ANALYSIS (CONTINUED)

3. FINANCIAL POSITION

- (1) As of 30th June 2006, the Company's total assets amounted to RMB8,406,210,000 and total liabilities amounted to RMB4,621,490,000, representing a gearing ratio of 54.98%. The current assets amounted to RMB2,860,970,000 and current liabilities amounted to RMB3,978,520,000, representing a liquidity ratio of 71.91%.
- (2) Due to the decreased sales volume, the Company's net cash inflow from operating activities and financing activities was RMB364,400,000 and RMB62,530,000 respectively in the first half of 2006. After deducting the net cash outflows of RMB422,400,000 from the Company's investment projects under construction such as the 50,000 steamer generator and the medium plate heat processing production line for reduction of consumption and increase of added value on products, the Company's cash inflows and outflows during the period maintained balanced. As of 30th June 2006, the Company's bank balance and cash amounted to RMB455,750,000.

