



## Management Discussion and Analysis

### OVERVIEW

In 2006, the Group took much effort in expanding production scale and adjusting product mix, thus achieving a historic high production and sales volumes in its Steel manufacturing segment. This segment also enjoyed a breakthrough increase in export volume, exemplifying its competitiveness in the international market.

For the year ended 31 December 2006, the Group recorded a consolidated turnover of HK\$6,467.5 million, representing a sharp increase of 41.5%, equivalent to HK\$1,897.5 million, when compared to that of last year. Despite higher finance expenses and raw material cost, net profit attributable to shareholders still amounted to HK\$221.6 million, representing a decrease of 27.1% when comparing to HK\$303.9 million last year (restated). Basic and diluted earnings per share for the year 2006 were HK3.9 cents and HK3.7 cents respectively.

#### 1. Strengthened production scale of Steel manufacturing segment

Commencement of Phase II of Qinhuangdao Shouqin Metal Materials Co., Ltd. (“Shouqin”) in the first half of the year has significantly expanded the Group’s scale of production. During the year, the Group produced 829,000 mt of steel plates and 1.94 million mt of steel slabs, representing a rise of 13.4% and 74.8% respectively over that of last year. Such a production scale saw a historic record level for the Group.

#### 2. Hyundai Heavy Industries as our Strategic partner

Hyundai Heavy Industries Co., Ltd. (“Hyundai”) is a world leader in ship-building and a heavy user of steel plates. By partnering with Hyundai through its subscription with a significant minority position with Shouqin, our subsidiary can strengthen its shareholder base and also secure a fair amount of sales of its thick plates. The said transaction has already been completed on 7 February 2007, after which the Group still holds 76% effective interest in Shouqin. We are confident that it would be beneficial for all parties involved.



#### 3. Secured equity and loan financing totaling HK\$1.66 billion

In the first quarter of the year, Carlo Tassara International S.A. has become one of the major shareholders of the Company, which subscribed for 929 million ordinary shares of the Company, the said subscription has provided net proceeds of approximately HK\$492.0 million to the Company for working capital purposes. In addition, the Company has secured a US\$150.0 million consortium loan financing. Part of the proceeds has already been applied to increase the capital base of Shouqin to progress on its business plan.

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### FINANCIAL REVIEW

*Year ended 31 December 2006 compared to year ended 31 December 2005*

#### Turnover and Cost of Sales

For the year under review, the Group recorded a consolidated turnover of HK\$6,467.5 million as compared to HK\$4,570.0 million last year, representing an increase of HK\$1,897.5 million, or 41.5%. The increase is principally due to full consolidation of Shouqin's results in the year, whereby only 2 months' results of November to December 2005 were included last year. Sales volume of steel products also rose significantly during the year.

Cost of sales in the current year was HK\$5,604.4 million as compared to HK\$4,143.1 million last year, representing an increase of HK\$1,461.3 million, or 35.3%. The resulting gross profit margin was 13.3% in the current year, improved from 9.3% last year, principally due to a change in revenue mix that the contribution by steel trading segment with an overall gross profit margin of about 2% is lower, making the overall figure still higher.

#### Other income

Other income increased from HK\$61.6 million last year to HK\$102.2 million this year, or 65.9%. The rise is mainly represented by tax refund on re-investment in China and increased bank interest income.

#### Finance costs

In the current year, finance costs increased to HK\$260.8 million, comparing to HK\$39.9 million last year, or 5.5 times. The increase is attributable to combination of higher leverage of Shouqin due to expansion and the interest expenses of the Company's newly-incepted consortium loans.

### REVIEW OF OPERATIONS

#### Steel manufacturing

The Group operates in this business segment through a wholly-owned subsidiary Qinhuangdao Shougang Plate Mill Co., Ltd. ("Qinhuangdao Plate Mill") and 96%-owned Shouqin. This segment contributed to 70% of the Group's turnover (2005: 60%). China maintains its rapid economic expansion with GDP growth reaching 10.7% in 2006, such strong growth is expected to continue well into the foreseeable future. However, the development of the iron and steel industry did not fully match with the growth in demand, with apparent structural incompatibilities. Raw materials and energy prices have been increasing; global price of iron ore has increased by 19% in 2006, and will continue to increase by 9.5% in 2007. Consolidated price index for steel products rose from 93.3 in January, to 114.85 in June and retreated to 105.15 at the end of the year. The high fluctuation is a fair proof of a generally difficult business environment for the industry.



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### *Qinhuangdao Plate Mill*

Turnover of Qinhuangdao Plate Mill was HK\$2,922.3 million (before elimination of intersegment sales) for the year, representing an increase of HK\$7.5 million from that of last year. Although the sales volume has increased from 689,000 mt to 761,000 mt this year, the average selling price per mt has decreased by approximately 6.4%. While the decrease in selling price cannot be offset by a corresponding decrease in cost of steel slabs, one of the major raw materials, and other manufacturing overheads, the gross profit margin has therefore deteriorated to 7.8%, against 9.3% last year. Net profit for the current year (excluding the share of 24% results in Shouqin) was HK\$90.2 million, comparing to HK\$152.1 million recorded in the last year. The decrease can be explained by the lower gross profit described above, and increased selling cost resulting from more export businesses.

### *Shouqin*

Shouqin houses a production line commanding some of the most advanced technologies in the world. Since its inception in mid 2004, the scale of production has been expanding significantly. Phase II of the plant started production in the first quarter of 2006, initially with output of steel slabs only. Its 4300mm width plate rolling system commenced production since October this year. Phase I embraces a designed production capability of 1.2 million tonnes, while Phase II can well reach 1.6 million tonnes. Shouqin achieved good performance and recorded a turnover of HK\$4,912.5 million for the current year, comparing to HK\$3,136.3 million last year, representing a rise of 56.6%. Approximately 1,850,000 mt of steel slabs were sold in 2006, representing an increase of 68.3% on a year-to-year basis, in addition to 9,700 mt of thick plates. Despite the apparent decline in steel product price in the first quarter which caused a negative impact on sales revenue and earnings, Shouqin's full year operation in 2006 was deemed satisfactory.

For the year ended 31 December 2006, net profit attributable to the Group from Shouqin amounted to HK\$44.2 million, versus a profit contribution of HK\$36.1 million last year, registering an increase of 22.4%. The higher profit contribution is owing to higher gross profit amount and by stringent cost containment measures, which were partially offset by increased finance cost from its leverage and negative change of tax rebate from export activities.

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### Shipping operations

Shougang Concord Shipping Holdings Limited and its subsidiaries ("Shougang Shipping Group") was mainly engaged in the time charter business. This segment has reported a satisfactory result. In the current year, its turnover was HK\$229.1 million and realized HK\$83.6 million in operating profit. When comparing to last year, turnover has decreased slightly by 1% while its operating profit has increased by 17.7%. Carriage tariff is steadier in the shipping market this year. The higher operating profit was a result of rent-free period during July to August from ship maintenance. For the year ended 31 December 2006, Shougang Shipping Group reported a net profit attributable to shareholders of HK\$79.5 million, an increase of HK\$10.0 million from that of 2005. Shougang Shipping Group has managed to maintain its expenses to a minimum level to partially reduce the adverse impact of fluctuating market rates.



### Electricity generation

Our 51%-owned Beijing Shougang Firstlevel Power Co., Ltd. ("Beijing Power Plant") reported total turnover of HK\$424.6 million for the current year, representing an increase of 3.3% from last year. After deducting minority interests, the Group's share of profit of Beijing Power Plant for the current year amounted to HK\$29.5 million, which showed a moderate increase of 2.4% as compared to HK\$28.8 million for the last year.

In the current year, Beijing Power Plant sold approximately 1,161 million kwh of electricity and generated sales revenue of HK\$364.4 million, recording a slight decrease of 1.0% and an increase of 2.8% respectively when comparing to that of last year. Higher profitability for the current year is a result of increase in market tariff and successful cost savings in the company.



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### Manufacture of steel cord for radial tyres; processing and trading of copper and brass products

Shougang Concord Century Holdings Limited and its subsidiaries ("Shougang Century Group") performed well above expectation and reported a turnover of HK\$678.9 million and net profit of HK\$76.0 million for the current year, representing a growth of HK\$86.0 million in turnover and HK\$13.8 million in net profit over that of last year. If the deemed loss arising from share reform plan of one of its associates were excluded, its net profit would be further boosted by HK\$6.9 million, recording a 33.2% increase in net profit on a year-to-year basis. With a slight drop in equity proportion from 27.9% to 22.5% due to share placement, the Group's share of its net profit still rose from HK\$17.4 million to HK\$21.0 million in the current year, representing an increase of 20.7%.



Shougang Century Group enjoyed a marked increase in sales and profit of its processing and trading of copper and brass product segment. Turnover of this segment increased by 72.3% to HK\$283.7 million and the corresponding gross profit grew by 261.7% to HK\$45.1 million. The growth can be explained by the sharp increase in copper price by 72.0%. The LME Copper Futures once recorded 82.0% gain during the year and still commanded 43.9% growth on a year-to-year basis. The other operating segments of Shougang Century Group also performed satisfactorily and contributed to the overall success in the current year.

### Trading of steel products; manufacture and installation of kitchen and laundry equipment

Shougang Concord Steel Holdings Limited and its subsidiaries ("Shougang Steel Group") reported turnover of HK\$1,302.2 million, representing a 11.9% growth in comparison with last year. In terms of turnover, trading of steel products has increased by 11.9% to HK\$1,216.0 million, while that of the installation of kitchen and laundry equipment has increased by 11.7% to HK\$86.2 million. However, with smaller spread in trade, Shougang Steel Group reported an overall lower net profit by 3.1% to HK\$18.8 million in the current year, comparing to HK\$19.4 million last year.

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### LIQUIDITY AND FINANCIAL RESOURCES

We aim to diversify our funding sources through utilization of both banking and capital markets. To the extent possible, financing is arranged to match business characteristics and cash flows.

#### 1. Leverage

The financial leverage of the Group as at 31 December 2006, as compared to 31 December 2005, is summarized below:

	<b>31 December 2006</b>	31 December 2005	
	<b>Audited</b>	Audited	Change
	<b>HK\$ million</b>	HK\$ million	
Total Debt			
– from banks	<b>4,577</b>	2,424	+88.8%
– from parent company	<b>1,125</b>	796	+41.3%
– from a related company	–	242	-100%
Sub-total	<b>5,702</b>	3,462	+64.7%
Cash and bank deposits	<b>1,855</b>	762	+143.4%
Net debt	<b>3,847</b>	2,700	+42.5%
Total capital (Equity and debt)	<b>8,645</b>	5,638	+53.3%
Financial leverage			
– Net debt to total capital	<b>44.5%</b>	47.9%	-7.1%
– Net debt to total assets	<b>34.2%</b>	36.3%	-5.8%

It can be observed that financial leverage has improved between 31 December 2006 and that of 31 December 2005, although the total debt level has increased, corresponding to the fact that Group debt financing is used in a controlled manner.

#### 2. Currency and Interest Rate Risk

The Group conducts its businesses mainly in Hong Kong and Mainland China, therefore it is subject to the foreign exchange fluctuations of HK Dollars, US Dollars and Renminbi. To minimize currency exposure, non Hong Kong Dollar assets are usually financed in the same currency as the asset or cash flow from it via borrowings. For the year ended 31 December 2006, approximately 76.4% of the Group's turnover was denominated in Renminbi. A mixture of fixed and floating rate borrowings are used in order to stabilize interest costs despite rate movements.



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### CAPITAL STRUCTURE

At the beginning of the current year, the issued share capital of the Company was HK\$986.8 million, represented by 4,934,057,214 ordinary shares at par value of HK\$0.20 each. During the year, the Company entered into a share subscription agreement on 13 February 2006 with an independent investor, Carlo Tassara International S. A. (“the Subscriber”), pursuant to which the Subscriber subscribed for 929,000,000 new ordinary shares of the Company at HK\$0.53 per share in March 2006. Moreover, a former director of the Company exercised the granted options, pursuant to which 1,000,000 new ordinary shares were issued at the exercise price of HK\$0.295 per share. As a result of the aforesaid events, the issued share capital of the Company increased to HK\$1,172.8 million, represented by 5,864,057,214 ordinary shares as at 31 December 2006.

### EMPLOYEES, REMUNERATION POLICIES AND TRAINING SCHEME

The Group has a total of approximately 4,200 employees as at 31 December 2006.

The remuneration policies of the Group are to ensure fairness and competitiveness of total remuneration in order to motivate and retain current employees as well as to attract potential ones. Remuneration packages are carefully structured to take into account local practices under various geographical locations in which the Group operates.

The remuneration packages of employees in Hong Kong include salary, discretionary bonuses, medical subsidies and a hospitalization scheme. All of the subsidiaries of the Group in Hong Kong provide pension schemes to the employees. The remuneration packages of employees in the PRC include salary, discretionary bonuses, medical subsidies and a welfare fund contribution as part of their staff benefits.

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### PROSPECTS

While Phase II of Shouqin has been operational since 2006, the Group has enhanced its world leading production lines. With a progressive development in high-end products, in addition to a more stable sales market and funding capability, the Group is considered extremely competitive in its forefront.

Fixed asset investment in China is expected to grow 20% in 2007, with steel production increased by 11%. The steady growth in China's GDP has benefited the steel industry as a whole. As China's new Steel Industry Policy progressively gets implemented, small and obsolete production capacities will soon be eliminated, profitability in the industry is on the rise. We now have a higher production capability than ever in the steel manufacturing segment in a business where scale is a key to success, both in terms of serving our customers better and maximizing our earnings premium in the market. Shougang Concord International is well positioned to benefit in the year 2007 for the continued market cyclical uprising.

