

In 2006, affected by reduction in steel price in the second half of 2005, the average price of all steel products of the Company was reduced by 9.97%. The Company surmounted the harsh reality effectively through multiple measures, such as sales promotion, production increase, adjustment of product mix, and consumption and cost reduction, and achieved growth in both production and sales volume and operation results. As at 31st December 2006, the Company's sales revenue amounted to Rmb9,612,900,000, representing an increase of 8.55% as compared with last year, and the net profit was Rmb314,840,000, increased by 21.29% over last year.

## (I) Principal operation of the Company during the reporting period under the PRC accounting standards

For the year 2006, the Company's sales revenue amounted to Rmb9,612,900,000, of which Rmb9,004,840,000 was derived from sales of steel products, representing 93.67% of the total revenue, up 8.32% over last year, and Rmb60,806,000 was derived from sales of non-steel products, such as water granulated slag, coking by-products, cutting steel leftover and hydroelectricity, which accounted for 6.33% of the total revenue, down 11.98% from last year.

Product	2006		2005		Year-on-year increase (%)
	Amount (Rmb0'000)	Percentage (%)	Amount (Rmb0'000)	Percentage (%)	
Steel plates	419,695	43.66	403,392	45.55	4.04
Steel sections	240,033	24.97	185,086	20.90	29.69
Wire rods	124,501	12.95	100,657	11.37	23.69
Steel billets	88,996	9.26	119,386	13.48	-25.46
Cold rolled plates	27,259	2.84	22,792	2.57	19.60
Subtotal	900,484	93.67	831,313	93.87	8.32
Others	60,806	6.33	54,300	6.13	11.98
Total	961,290	100.00	885,613	100.00	8.55

In 2006, the sales revenue of the Company's steel products (billets) increased by Rmb691,710,000 as compared with last year, which was attributable to an increase in production and sales volume partially offset by a decrease in selling prices. During the year, the Company sold 2,883,600 tonnes of steel products (billets), representing an increase of 20.35% over last year which increased sales revenue by Rmb166,060,000. Meanwhile, the average selling prices of steel products (including cold rolled plates) was Rmb3,123 per tonne, representing a decrease of 9.97% from last year which decreased sales revenue by Rmb968,890,000.

### Sales volume by products

Product	2006 (0'000 tonnes)	2005 (0'000 tonnes)	Year-on-year increase (%)	Contribution to revenue (Rmb0'000)
Steel plates	119.53	103.02	16.03	64,637
Steel sections	85.71	59.29	44.56	82,483
Wire rods	44.05	32.94	33.73	33,952
Steel billets	31.89	38.65	-17.49	-20,882
Subtotal	281.18	233.90	20.21	160,190
Cold rolled plates	7.18	5.71	25.74	5,870
Total	288.36	239.61	20.35	166,060

## MANAGEMENT DISCUSSION AND ANALYSIS (CONTINUED)

### (I) Principal operation of the Company during the reporting period under the PRC accounting standards *(Continued)*

#### Sales price by products

Product	2006 (Rmb/tonnes)	2005 (Rmb/tonnes)	Year-on-year increase (%)	Contribution to revenue (Rmb0'000)
Steel plates	3,511	3,915	-10.32	-48,290
Steel sections	2,800	3,122	-10.31	-27,557
Wire rods	2,826	3,056	-7.53	-10,132
Steel billets	2,791	3,089	-9.65	-9,482
Subtotal	3,106	3,457	-10.15	-95,482
Cold rolled plates	3,797	3,993	-4.91	-1,407
Total	<u>3,123</u>	<u>3,469</u>	<u>-9.97</u>	<u>-96,889</u>

### (II) Assets and liabilities of the Company during the reporting period in accordance with the PRC accounting standards

As at 31st December 2006, the total assets of the Company amounted to Rmb8,841,430,000, representing a year-on-year increase of 9.07%, and the total liabilities amounted to Rmb4,849,920,000. The gearing ratio was 54.85% and the current assets/current liabilities ratio was 0.74.

### (III) Period expenses and income tax of the Company during the reporting period under the PRC accounting standards

As at 31st December 2006, the administrative expenses of the Company amounted to Rmb196,530,000, increased by Rmb18,930,000 over last year, which was mainly attributable to the increase in salary and additions booked in administrative expenses for the year. The operating expenses amounted to Rmb195,790,000, representing an increase of Rmb45,410,000 as compared with last year, which was attributable to the increase in transportation charges by Rmb25,390,000 and shipbuilding inspection expenses by Rmb12,320,000 as a result of increased sales volume, and to an increase of export expenses by Rmb7,110,000 derived from exporting 39,200 tonnes of steel plates in 2006. The financial costs amounted to Rmb163,170,000, increased by Rmb46,160,000 over last year, which was mainly attributable to the increase in bank loans and interest as a result of production expansion. The income tax rate of the Company was 15% for the year 2006. The income tax payable was Rmb1,090,000 by deducting the income tax exemption for domestically produced equipment from the accrued income tax of Rmb53,490,000.

## MANAGEMENT DISCUSSION AND ANALYSIS (CONTINUED)

### (IV) Operating results of the Company during the reporting period under the PRC accounting standards

The net profit amounted to Rmb314,840,000 for the year 2006, representing a year-on-year increase of Rmb259,580,000 by 21.29%, which is mainly attributable to increased gross profit and decreased income tax.

Item	2006 Amount (Rmb'000)	2005 Amount (Rmb'000)	Year-on-year increase (%)
I. Revenue from principal operations	9,612,897	8,856,126	8.55
Cost of principal operations	(8,747,813)	(8,129,125)	7.61
II. Profit from principal operations	865,084	727,001	18.99
Profit from other operations	9,558	10,922	-12.49
Total expenses	(555,488)	(444,987)	24.83
III. Operating profit	319,154	292,936	8.95
IV. Total profit	315,930	292,239	8.11
Income tax	(1,093)	(32,663)	-96.65
V. Net profit	314,837	259,576	21.29

**1. Gross profit from principal operations increased by Rmb138,080,000 over last year, which was attributable to:**

- (1) Increase in sales volume: During the reporting period, the sales volume of the Company's steel products (billets) increased by 487,500 tonnes, resulting in an increase of Rmb135,530,000 in gross profit.
- (2) Cost reduction: The gross profit of the Company increased by Rmb943,230,000 through such cost cutting measures as exploring potentials to increase production, optimizing ore proportioning plan, saving energy and reducing consumption and reducing procurement cost.
- (3) Reduction in selling price: In the first quarter of 2006, the prices of steel products in China were on the low side, and began to rise from April. However, the average price of steel products of the Company was Rmb323/tonnes, representing a reduction of 9.97% over last year, which resulted in a decrease in gross profit of Rmb968,890,000.
- (4) Increase in sales of non-steel products, such as water granulated slag, coking by-products, cutting steel leftover and hydroelectricity, resulting in an increase of Rmb28,210,000 in gross profit.

**2. The expenses during the period increased by Rmb110,500,000 over last year (For reasons, see the above-mentioned related section).**

**3. An increase of Rmb52,400,000 in profit was derived from the Income tax exemption for domestically produced equipment.**

### (V) Cash flow of the Company during the reporting period, under the PRC accounting standards

1. In 2006, net cash from operating activities of the Company amounted to Rmb854,230,000, accounting for 271.32% of the net profit of the Company for the year, and the cash flow for operating activities was sufficient, which was mainly attributable to an increase in advance payments and payables. During the reporting period, the net cash was decreased by Rmb137,450,000 due to the increase in net expenses for investment activities and financing activities of the Company.

# MANAGEMENT DISCUSSION AND ANALYSIS (CONTINUED)

## (V) Cash flow of the Company during the reporting period, under the PRC accounting standards (Continued)

- In 2006, net cash expenses in the Company's investment activities in a series of technological renovation amounted to Rmb604,290,000, mainly including the overhaul to blast furnace No.4, renovation of the production line of heat treatment for medium plates, and the project of 50MW gas-steam combined cycle power generating sets etc.
- In 2006, the net cash expenses of the Company related to financing activities amounted to Rmb387,390,000, including activities of issuing cash dividend for 2005 and for the first half of 2006, and paying interest.

## (VI) Principal operations by industry and product

(Rmb'000)

By industry	Revenue from principal operations	Cost of principal operations	Gross profit ratio (%)	Increase/decrease in revenue from principal operations over last year (%)	Increase/decrease in cost of principal operations over last year (%)	Up/down in gross profit ratio over last year (%)
Iron & Steel industry	9,004,844	8,227,287	8.63	8.32	7.61	0.60
By product						
Steel plates	4,196,946	3,451,338	17.77	4.04	6.78	-2.11
Steel sections	2,400,326	2,381,144	0.80	29.69	25.21	3.55
Wire rods	1,245,013	1,213,491	2.53	23.69	17.90	4.78
Steel billets	889,964	870,567	2.18	-25.45	-26.48	1.37
Cool rolled thin sheets	272,595	310,747	-14.00	19.60	4.23	16.81

## (VII) Principal operations by region

(Rmb'000)

Region	Revenue from principal operations	Increase/decrease in revenue from principal operations over last year (%)
South-western region	5,583,491	3.08
Other regions	4,029,406	12.16

## (VIII) Major suppliers and customers

Percentage in total procurement for Major suppliers of the Company:

Percentage in total procurement for the largest supplier of the Company: 11.38%

Percentage in total procurement for the top five suppliers of the Company: 37.13%

Percentage in total sales for major customers of the Company:

Percentage in total sales for the largest customer of the Company: 3.39%

Percentage in total sales for the top five customers of the Company: 14.34%

Save for two fellow subsidiaries in the top five suppliers and one fellow subsidiary in the top five customers of the Company, none of directors, supervisors or their respective associates or any shareholder (which to the knowledge of the directors has 5% or more of equity interest in the Company) of the Company was beneficially interested in the top five suppliers or the top five customers of the Company.