

Management Discussion and Analysis

REVIEW OF RESULTS

The turnover of the Group for the year was approximately RMB941,577,000, representing an increase of approximately 44% compared with approximately RMB654,273,000 for the last year while the net profit was approximately RMB41,229,000, representing an increase of approximately 40% compared with approximately RMB29,444,000 for the last year.

BUSINESS REVIEW

The significant growth in operating results is primarily due to the fact that the Group is still in the stage of development and its market share is increasing. Sales volume increased from 128,436 tonnes for the last year to 141,971 tonnes, representing an increase of approximately 11% while at the same time, the selling price of the Group's products increased by approximately 30% compared with that for the corresponding period last year mainly because of the continuous surge of the price of international and domestic steel products during the year, resulting in an increase in profit for the Group.

PRODUCTION AND SALES

The revenue from domestic sales of products in the PRC during the year was approximately RMB145,406,000, representing an increase of approximately 102% compared with approximately RMB71,959,000 last year. Meanwhile, the Group is still developing the domestic market in the PRC.

The revenue from indirect export sales of products in the PRC during the year was approximately RMB789,859,000, representing an increase of approximately 36% compared with approximately RMB580,628,000 for the last year. The market for indirect export sales in the PRC continued to be the core market for the Group.

The revenue from direct export sales of products outside the PRC during the year was approximately RMB6,312,000 while it was only approximately RMB1,686,000 for the last year. The Group has successfully entered the international market, in particular, its recently launched new product (stainless steel pipes) has been exported to countries such as the U.S. and Vietnam.

GROSS PROFIT

The Group recorded a gross profit of approximately RMB99,378,000 for the year, with a gross profit margin of approximately 10.6%, compared with the gross profit of approximately RMB64,566,000 and a gross profit margin of approximately 9.9% for the last year.

Management Discussion and Analysis *(Continued)*

OPERATING EXPENSES

The total operating expenses of the Group for the year were approximately RMB47,375,000, of which approximately RMB9,954,000 in selling and distribution costs, RMB28,124,000 in administrative expenses, RMB3,922,000 in other operating expenses and RMB5,375,000 in finance costs, accounting for approximately 1.1%, 3.0%, 0.4% and 0.6% of turnover respectively while the amounts for the last year were approximately RMB8,580,000, RMB15,197,000, RMB1,255,000 and RMB3,272,000 respectively, accounting for approximately 1.3%, 2.3%, 0.2% and 0.5% respectively. The increase in the operating expenses was mainly due to the increase in turnover, which resulted in the rise of variable expenses. However, these expenses had comparably lower percentages of turnover in the year.

FINANCIAL RESOURCES AND TREASURY POLICIES

The Group continues to adhere to prudent treasury policies. The gearing ratio (borrowings divided by shareholders' funds) as of 31 December 2004 was approximately 100.7% (2003: 132.8%). The total bank borrowings of the Group amounted to approximately RMB230,807,000 (2003: RMB187,483,000), mainly denominated in US dollars, HK dollars and Renminbi with floating interest rates. The Group's short term loans from banks accounted for approximately 42.6% of the total assets (2003: 49.3%).

The current ratio (current assets divided by current liabilities) as of 31 December 2004 was approximately 1.74 (2003: 1.53). In 2002, the Group started to insure against receivables in order to lower the risks of credit sales and to ensure that funds would be recovered on a timely basis, hence fulfilling the requirements for debt repayments and working capital commitments.

CASH FLOW

Net cash inflow of approximately RMB5,421,000 was generated from operating activities for the year, reflecting growth in core business of the Group. Despite approximately RMB22,538,000 used for plant expansion and purchase of machinery and equipment, the net increase in cash and cash equivalents amounted to approximately RMB68,447,000, as a result of net cash inflow of approximately RMB46,556,000 raised from the listing, approximately RMB43,324,000 from bank borrowings and strong operating cash inflow. Bank balances and cash as at 31 December 2004 totalled approximately RMB103,481,000, mainly denominated in US dollars, HK dollars and Renminbi.

EXCHANGE RATE EXPOSURES

As most of the Group's monetary assets and liabilities are denominated in US dollars, HK dollars and Renminbi and those currencies remained relatively stable during the year, the Group was not exposed to any significant exchange risk.

PLEDGE OF ASSETS

As at 31 December 2004, property, plant and equipment and land use rights of the Group with net book value of approximately RMB60,567,000 (2003: RMB38,358,000) and RMB9,082,000 (2003: RMB9,304,000) respectively were pledged to secure bank borrowings.

Management Discussion and Analysis *(Continued)*

CONTINGENT LIABILITIES

The Group did not have any significant contingent liabilities at the balance sheet date. At 31 December 2004, the Company had provided corporate guarantees of RMB173,808,000 (2003: Nil) in favour of certain banks for banking facilities granted to a subsidiary. Out of which, approximately RMB104,320,000 had been utilised at 31 December 2004 (2003: Nil).

EMPLOYMENT, TRAINING AND DEVELOPMENT

As at 31 December 2004, the Group had a total of 329 employees. Total staff costs for the year ended 31 December 2004 were approximately RMB17.7 million, including retirement benefits cost of RMB1.4 million. Remuneration packages of the Group are maintained at a competitive level to attract, retain and motivate employees and are reviewed on a periodical basis.

The Group always maintains good relation with its employees and is committed to employee training and development on a regular basis to maintain the quality of our products.

In addition, the Company has a share option scheme for the purpose of providing incentives and rewards to eligible participants. No option has been granted under the scheme since its adoption.

OUTLOOK

Following the completion of Phase III of our plant in July 2004 and the new installation of steel-cutting and pipe-making machines, the Group's future production capacity and market competitiveness would be further enhanced. Moreover, the Group's new product (stainless pipes) has already been launched to the domestic market in the PRC as well as the international market, and has duly obtained the Hygiene Permit for Stainless Steel Pipes from the Guangdong Province Health Bureau, which would significantly help to promote the Group's new products in the market.

To sustain the development of the Group, we are giving full consideration to every investment opportunity which are beneficial to the Group, with an aim to generate the best return from investments.

Looking forward to 2005, the Group's management is confident that our business will continue to grow in future and generate better returns to our investors.