Chang Kang Lung, Jason
Chief Executive Officer

Based on the precise judgment on the volatile business environment, the Group emphased on risk management measures in 2004, it will continue to be the focus of management in 2005.

In 2004, the PRC's economy and the cement industry grew rapidly. In order to maintain sustainable growth of the national economy, the Central Government introduced certain austerity control measures. Though this resulted in a squeeze on the cement sector, from a long-term point of view, it will be beneficial to sustainable development of the industry, especially for large cement conglomerates with financial and technological advantages.

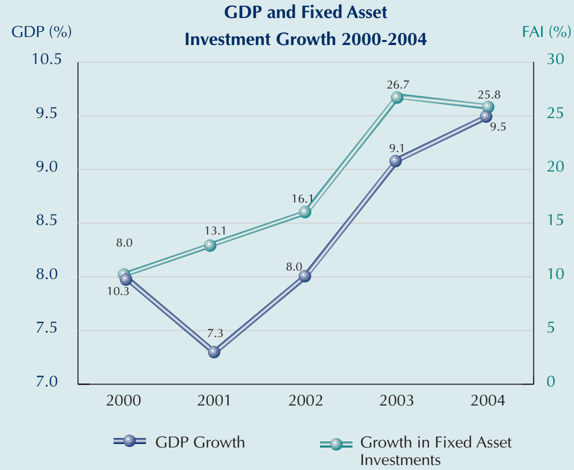
I. 2004 OPERATING ENVIRONMENT

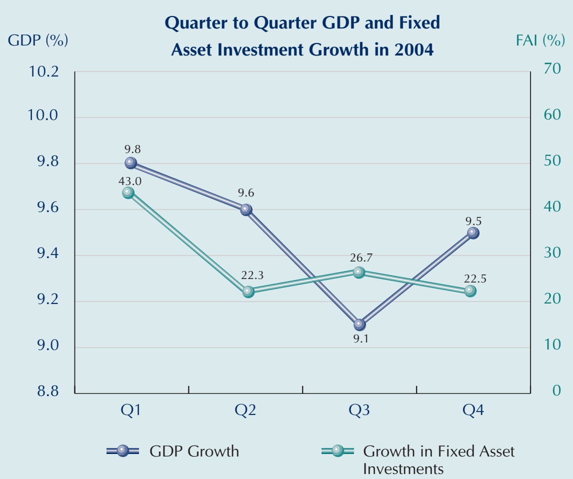
1. Steady economic growth, slowing fixed asset investments, and shortage in energy supply

In 2004, growth in the PRC economy remained strong. Annual GDP grew by 9.5% from 2003, for the first quarter with growth of 9.8%, 9.6% for the second quarter, 9.1% for the third quarter, and 9.5% for the fourth quarter. The slight tapering of GDP growth towards the end of the year was mainly due to austerity control measures introduced by the government. However, this did not adversely affect the economy.

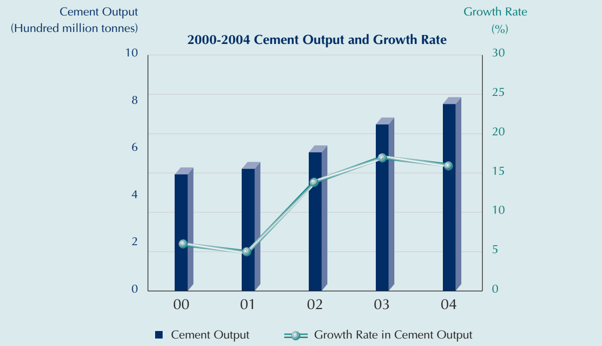
Fixed asset investments grew by 25.8% from 2003, a slowdown due to austerity control measures taking effect. The government initiated various policies, such as limiting land use, tightening the approval of investment applications, and increasing capital requirement to 35% and above for industries such as cement, aluminum and real estate, in efforts to cool the economy. The slowing of fixed asset investments also led to a decrease in cement consumption.

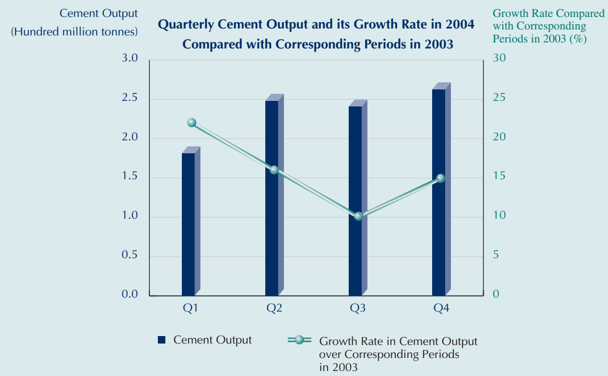
GDP and Fixed Asset Investment Growth 2000-2004





Source: National Bureau of Statistics of China





Source: China Cement Association

One bottleneck for growth in 2004 was the shortage in energy supply. Coal supply was tight and prices kept increasing. Insufficient electricity supply led to production stoppages during the summer months. At the same time, higher prices for coal used by power plants led to pressure for increase in electricity prices. Due to these reasons, production costs for the cement industry grew significantly in 2004. These circumstances, however, highlight the competitive advantage of the larger, better equipped, and more efficient energy consumption players in the cement industry.

2. Continuous growth in the cement sector, hastening consolidation

Overall cement demand for 2004 remained strong, and output increased to 930 million tonnes, a growth of 15.7% from 2003. Compared to the growth rate of 2003, this was a slowdown of 1 percentage point. Affected by austerity control measures and slowing demand supply growth rate rapidly declined in the second quarter and further decreased in the third quarter as shortages in electricity limited production. Supply rose in the fourth quarter mainly due to the coming on line of new capacity.

2004 cement prices started high and ended low. Fixed asset investment remained strong in the first quarter fueling demand for cement, driving prices up. As we entered the second half of the year, fixed asset investment began to slow down, while cement output continued to increase, leading to a decline in cement prices. Paired with the increases in energy costs, profit margins deteriorated in the second half of the year.

Government initiatives in restructuring the cement industry, together with the squeeze on profit margins, have increased the pace of consolidation. In 2004, the proportion of dry process kilns reached 45% of all clinker lines, and bulk cement ratio reached 33.47% from 29.58% in 2003. A total of 143 new facilities came on line in 2004, with approximately 61% of these in the Eastern China region. Total capacity of cement and clinker increased by approximately 130 million tonnes.

At the same time, China exported approximately 7 million tonnes of cement and clinker in 2004, representing a 30% increase from 2003. Main markets include Korea, United States, Hong Kong, and Taiwan.

II. 2005 OPERATING ENVIRONMENT OUTLOOK

1. Steady economic growth, tight energy supply

Economic growth should remain steady in 2005. It is forecasted that GDP for 2005 will be slightly lower than that of 2004. The PRC government has adjusted their forecasts to 8% from 7% and the State Development and Restructuring Commission has estimated an 8-8.5% GDP growth for 2005.

Growth in fixed asset investment will be maintained at a certain level. According to the State Development and Restructuring Commission, fixed asset investment in 2005 will grow at a rate of 18%. From 2006, the government intends to invest RMB100 billion over the next 5 years for the construction of highways in the rural areas, and from 2005-2020 RMB2,000 billion is expected to be invested in railway construction. All this should help sustain cement demand going forward.

We expect energy supply, mainly coal supply, to remain tight, with further room for prices to increase. The national power company estimates that there will be a shortage of 20 million kw of power for 2005 and electricity prices still face upward pressure. All this can create further pressure on margins for the cement industry.

2. Intense competition facilitating consolidation

With pressures on profit margins, new capacity entering the market, and a gradual slowdown in demand, 2005 should see a ramp up in consolidation of the industry. According to the State Development and Restructuring Commission, cement prices in 2005 will continue to gradually decline, with the potential of a slight rebound in the fourth quarter. Because of the competition and decrease in profitability of the domestic market, it is expected that China will increase its cement export in 2005.

The government has also revised the "Ozone Pollution Compliance Standard for the Cement Industry" (GB4915-2004), effective January 2005, which will increase the standard of compliance for emissions from cement plants.

Faced with the challenging conditions of the industry, the Group believes that the opportunities will outweigh the challenges and the larger cement players will benefit from the consolidation.