

Management Discussion and Analysis

Business Environment

2006 is the first year of the State's Eleventh Five-Year Plan. The overall macroeconomic economy of the State for the first 6 months of 2006 generally sustained a growing development trend. For the first six months, there was an approximately 31.3% increase in fixed asset investments and an approximately 10.3% growth in GDP. During the first half of 2006, the State introduced a series of austerity measures to foster changes in structural adjustment of the economy and pattern of economic growth.

During the first half of 2006, the cement industry proactively pursued the State's austerity measures and the prescribed policies on the cement industry. The industry took steps to promote the construction of large scale production lines with new-dry-process and to stop those cement projects which failed to meet the industrial policies. Most of the wet-process production lines either ceased production or were dismantled. Expansion of construction of low-efficiency, backward production lines (such as vertical kilns) was controlled effectively. Investment in the cement industry returned to a rational level and the rate of investment growth decelerated. Driven by the effects of increasing fixed asset investments and demands from the international cement market, new production capacity was gradually taken up by the market. The cement market showed clear improvements over the same period of last year and price level remained stable with an increasing trend.

Operation Overview

During the first half of 2006, the Company took proactive steps to respond to the changes in the macroeconomic environment by realigning operating strategies. It strenuously expanded the international market, increased the scale of exports and enhanced level of control over the domestic market. At the same time, the Company will devote its efforts in enhancing internal management, so that production, sales, logistics and project construction can be coordinated to operate with discipline. The Group's cement and clinker production and sales volumes, operating income and profit had significant growth over the same period last year.

For the sixth months ended 30 June 2006, the Group realised sales volume of 34.72 million tonnes, representing an increase of 43% over the same period last year. The Group's income from principal operations as reported in accordance with PRC Accounting Standards amounted to RMB6,740.24 million, representing an increase of 48.69% over the same period last year. Its net profit was RMB492.70 million, representing an increase of 357.62% over the same period last year; and earnings per share was RMB0.39. Under IFRS, the Group's net sales amounted to

Management Discussion and Analysis

RMB6,700.57 million, representing an increase of 48.46% over the same period last year; its profit after tax and minority interests amounted to RMB508.77 million, representing an increase of 456.55% over the same period last year; and its earnings per share was RMB0.41.

Breakdown of sales by products (prepared in accordance with the PRC Accounting Standards)

(Unit: RMB'000)

Products	January to June 2006		January to June 2005	
	Sales	Percentage (%)	Sales	Percentage (%)
Cement				
Grade 42.5	2,837,491	42.10	1,711,361	37.75
Grade 32.5	2,061,421	30.58	1,623,086	35.81
Sub-total	4,898,912	72.68	3,334,447	73.56
Clinker	1,841,330	27.32	1,198,617	26.44
Total	6,740,242	100.00	4,533,064	100.00

With the implementation of the strategic planning in connection with the Eleventh Five-Year Plan, there was an increase in the number of infrastructure construction projects. New rural construction projects also commenced in full scale. These pushed up the consumption demands for cement at a stable level. During the first half of 2006, the Group has secured cement orders from a number of key engineering projects, including a few expressways and railways, the Shanghai Yuejiang Tunnel and Phase 2 of the Pudong International Airport. In addition, the Group took proactive steps to increase its market share of the international cement market by capitalising on the opportunity of increasing international market demands for high grade cement. In terms of sales by products, sales of the grade 42.5 cement with better profitability increased by 65.80% over the same period last year with a growth in sales proportion by 4.35 percentage points, whereas sales of grade 32.5 cement and clinkers increased by 27.01% and 53.62% respectively over the same period last year.

Management Discussion and Analysis

Breakdown of sales by region (prepared in accordance with the PRC Accounting Standards)

(Unit: RMB'000)

Region	January to June 2006 Sales	Increase/ (decrease) (%)
Jiangsu Province	1,615,480	8.86
Zhejiang Province	666,816	(19.69)
Shanghai	463,080	4.54
Anhui Province	800,721	23.13
Jiangxi Province	351,711	10.53
Fujian Province	176,075	88.64
Hunan Province	172,620	50.40
Guangxi Province	536,752	—
Guangdong Province	360,412	—
Export	1,596,575	166.45
Total	6,740,242	48.69

During the Reporting Period, fuelled by increases in investments in infrastructure construction projects and new rural construction projects, growth in demands in regional markets such as Anhui and Fujian Provinces sustained growth with sales recorded period-on-period increases of 23.13% and 88.64% respectively.

At the same time, the Group accelerated its implementation of development strategy in Southern China by forming a market network gradually. Sales of Hunan, Guangxi and Guangdong region accounted for 15.84% of the Group's total sales.

Demands for cement of Zhejiang Province in Eastern China declined rapidly. During the Reporting Period, the Group's sales in that region recorded a period-on-period decrease of 19.69%.

Demands for cement in the international market maintained its rapid growth. Export sales of the Group in the first half of the year recorded a period-on-period increase of 166.45%.

Management Discussion and Analysis

Profit Analysis

An analysis of major changes to the Group's principal profit and loss items, prepared in accordance with PRC Accounting Standards, is set out as follows:

Major changes to the Group's principal profit and loss items, prepared in accordance with PRC Accounting Standards

(Unit: RMB'000)

Items	Amount		Difference as compared with same period last year (%)
	First half of 2006	First half of 2005	
Income from principal operations	6,740,242	4,533,064	48.69
Profit from principal operations	1,808,403	862,787	109.60
Total profit	935,014	222,260	320.68
Net profit	492,700	107,665	357.62
Net cashflow from operating activities	820,941	543,052	51.17

During the Reporting Period, the Group's profit from principal operations amounted to RMB1,808.40 million, representing a period-on-period increase of 109.60%; total profit amounted to RMB935.01 million, representing a period-on-period increase of 320.68%; net profit amounted to RMB492.70 million, representing a period-on-period increase of 357.62%. Growth in profit was primarily attributed to the period-on-period increase in sales by 43%, period-on-period increase in consolidated prices by 3.7% and period-on-period decrease in consolidated costs by 6.12%.

During the Reporting Period, another reason for the growth in profit was the sales achieved by Shuangfeng Conch, Xingan Conch, Kuiyang Conch and Xinning Conch totalling RMB709.37 million, accounting for 10.52% of the Group's income from principal operations and net profit totalling RMB102.41 million, accounting for 20.79% of the Group's net profit.

During the Reporting Period, the Group's consolidated gross margins recorded a period-on-period increase of 8.23 percentage points.

Management Discussion and Analysis

Gross profit by products for January to June 2006 and period-on-period comparison

(Unit: RMB'000)

Products	Income from principal operations	Costs of principal operations	Gross margin for Reporting Period (%)	Gross margin for same period of last year (%)	Difference as compared with the same period of the previous year (percentage points)
Grade 42.5	2,837,491	2,127,323	25.03	17.21	7.82
Grade 32.5	2,061,421	1,499,685	27.25	22.37	4.88
Clinker	1,841,330	1,265,163	31.29	18.76	12.53
Consolidated	6,740,242	4,892,171	27.42	19.19	8.23

Expenses

During the Reporting Period, the Group exercised sound control over all expenses. Administrative expenses, accounting for 3.09%, fell by 0.2 percentage points over the same period last year. Selling and marketing expenses, accounting for 8.03%, rose by 0.6 percentage points over the same period last year. Finance expenses, accounting for 3.79%, fell by 0.68 percentage points over the same period last year.

Financial Conditions

Asset and liability status

As at 30 June 2006, the Group's total assets, total liabilities and net assets, prepared in accordance with PRC Accounting Standards, amounted to RMB20,326 million, RMB12,931 million and RMB6,116 million respectively.

The gearing ratio (total liabilities/total assets), prepared in accordance with PRC Accounting Standards, was 63.62%, representing a decrease of 0.76 percentage points over the end of last year; while the debt-to-equity ratio (net bank borrowings/net assets), prepared in accordance with IFRS was 1.28, more or less at the same level as last year.

In response to market changes, the Group will rationally reallocate funds, improve efficiency of fund application, optimise loan portfolio and increase weighting in long-term loans appropriately.

Management Discussion and Analysis

Changes in balance sheet items, prepared in accordance with PRC Accounting Standards

(Unit: RMB'000)

Items	As at 30 June 2006	As at 31 December 2005	Increase/ (decrease) (%)
Fixed assets	15,897,067	15,091,128	5.34
Current and other assets	4,429,126	4,150,898	6.70
Total assets	20,326,193	19,242,026	5.63
Current liabilities	6,245,117	7,397,025	(15.57)
Non-current liabilities	6,685,558	4,990,774	33.96
Minority interests	1,279,320	1,142,793	11.95
Equity	6,116,198	5,711,434	7.09
Total liabilities and equity	20,326,193	19,242,026	5.63

Liquidity and source of funds

As at 30 June 2006, the Group's total current assets and total current liabilities, prepared in accordance with PRC Accounting Standards, were RMB3,723.55 million and RMB6,245.12 million respectively. The current ratio was 0.6:1.

As at 30 June 2006, the Group's total current assets and total current liabilities, prepared in accordance with IFRS, were RMB3,723.55 million and RMB6,245.13 million respectively. The net current liabilities were RMB2,521.57 million.

Maturity analysis of bank loans of the Group as at 30 June 2006 is as follows:

Maturity date	As at 30 June 2006 (RMB'000)	As at 31 December 2005 (RMB'000)
Due within 1 year	3,716,360	4,706,360
Due after 1 year but within 2 years	1,992,380	2,185,380
Due after 2 years but within 5 years	3,457,800	1,959,800
Due after 5 years	980,000	730,000
Total	10,146,540	9,581,540

The Group's pledge of assets is disclosed under note 12 of the notes to the condensed consolidated interim financial statements.

Management Discussion and Analysis

As RMB is the principal currency of the Group's major sales, purchases and expenses, the Board is of the opinion that the effect of foreign currency hedging risk is insignificant. Accordingly, during the Reporting Period, the Group did not undertake any foreign exchange hedging activities.

As at 30 June 2006, outstanding capital commitments in respect of the purchase of machinery and equipment for production purposes but not yet provided for in the accounts are as follows:

	As at 30 June 2006 (RMB'000)	As at 31 December 2005 (RMB'000)
Authorised and contracted for	1,688,420	1,449,180
Authorised but not contracted for	1,933,881	1,129,017
Total	3,622,301	2,578,197

A summary of the Group's net cashflow for the first six months of 2006, prepared in accordance with PRC Accounting Standards, is set out as follows:

	January to June 2006 (RMB'000)	January to June 2005 (RMB'000)
Net cashflow from operating activities	820,941	543,052
Net cashflow from investment activities	(1,262,080)	(1,697,882)
Net cashflow from financing activities	255,769	350,440
Net increase in cash and cash equivalents	(185,370)	(804,390)
Cash and cash equivalents at beginning of year	1,178,390	1,626,829
Cash and cash equivalents at end of period	993,020	822,439

During the Reporting Period, net cash outflow of the Group amounted to RMB185.37 million, a decrease in net outflow of RMB619.02 million over the same period last year, due to the Group's needs for investments in project construction.

Management Discussion and Analysis

Capital expenditure

During the Reporting Period, the aggregate of investment activities and capital expenditure of the Group amounted to RMB1,389 million, which was mainly applied in the construction of clinker and cement grinding production line projects, such as Yingde Conch, Wuhu Conch, Xuancheng Conch, Beiliu Conch, Baling Conch, Changfeng Conch and Taizhou Conch, as well as the construction of the residual heat electricity generation projects, like Ningguo Cement Plant.

Project Investments of the Group

1. Investments in significant projects during the Reporting Period

(Unit: RMB'000)

No.	Project name	Progress of Project	Amount invested during Reporting Period
1.	Four clinker production lines each with a daily capacity of 5,000 tonnes and its ancillary cement grinding system of Yingde Conch Cement Co., Ltd.	Operational	252,170
2.	Two cement grinding production lines each with a daily capacity of 5,000 tonnes and its ancillary cement grinding system of Phase 1 of Wuhu Conch Cement Co., Ltd.	Under construction	432,210
3.	Two clinker production lines each with a daily capacity of 5,000 tonnes and its ancillary cement grinding system of Phase 1 of Xuancheng Conch Cement Co., Ltd.	Under construction	49,690
4.	A clinker production line with a daily capacity of 5,000 tonnes and its ancillary cement grinding system of Beiliu Conch Cement Co., Ltd.	Under construction	68,550
5.	Expansion project of a cement grinding mill with an annual capacity of 3.2 million tonnes of Baling Conch Cement Co., Ltd.	Under construction	75,340
6.	A cement grinding mill with an annual capacity of 3.2 million tonnes of Maanshan Conch Cement Co., Ltd.	Operational	18,800
7.	Expansion project of a cement grinding mill with an annual capacity of 1.10 million tonnes of Changfeng Conch Cement Co., Ltd.	Under construction	34,660
8.	A cement grinding mill with an annual capacity of 1.65 million tonnes of Taizhou Conch Cement Co., Ltd.	Under construction	40,670
9.	Residual heat electricity generation project of Ningguo Cement Plant	Under construction	44,520
10.	Residual heat electricity generation project of Chizhou Conch	Under construction	6,100

Management Discussion and Analysis

No.	Project name	Progress of Project	Amount invested during Reporting Period
11.	Residual heat electricity generation project of Jiande Conch	Under construction	27,030

2. Investment in major project companies during the Reporting Period

During the Reporting Period, the Company did not make any new investment in project companies.

Outlook for the second half of 2006

During the second half of 2006, the State will continue to strengthen and enhance its austerity measures in securing effective control over the scale of fixed asset investments. It will further promote structural realignment of the industry, alter the pattern of economic growth, which will lead to gradual stabilisation in the prices of cement. Recently, pursuant to the “Certain opinion regarding the acceleration of the structural realignments of the cement industry” issued by 8 Ministries and Commissions of the PRC (including the State Development Reform Commission), large cement conglomerates will be given key supports in project approvals, land approvals and loan financing, which are favourable to the further concentration of the industry and will create more favourable room for the Company’s development.

The Company considers that the second half of the year is the traditional busy season when market demand will maintain its growth. As new production capacity gradually slowed down with improvements in supply-demand relationship, prices in the cement market will be stable but rising steadily. At the same time, slight declines in coal prices will be beneficial to the Company’s further reductions in production costs.

During the second half of the year, gradual completion and operation of projects under construction, like Wuhu Conch, will further promote the growth of the Company’s sales.