Section III The Company’s Business Profile

I. Principal Business and Operating Mode of the Company and Industry Information during the Reporting Period

1. Principal Business and Operating Mode during the Reporting Period

The Company is the most modernized super large iron & steel complex in China and an internationally leading world-class steel producer as well. The Company specializes in iron & steel production, and is also involved in the processing and distribution, chemical industry, information technology, finance, e-commerce and other business related to the principal business of iron and steel. The Company now is focusing its production at Shanghai base and Meishan Iron & Steel Co., Ltd., while speeding up its construction of Zhanjiang Iron & Steel Base.

With iron & steel manufacturing as the “one body”, the Company manufactures hi-tech and highly value-added premium steel products, such as carbon steel sheet, heavy plate and steel tubes & pipes. These premium steel products are not only extensively applied to industries such as automobile, household appliances, petrochemical, machinery manufacturing, energy and transportation, but also leading domestic market of six strategic products, namely automotive sheet, electrical steel, tin plate, steel for energy and pipeline, steel for high-grade ship and maritime works and other high-end thin sheets. In terms of manufacturing process and technical research & development, the Company’s overall technical equipment is based on contemporary state-of-the-art technologies for iron & steel melting, cold & hot working, hydraulic sensing, electronic control, computer, information and communications, with features of large size, continuity and automation, leading the world iron & steel industry while beyond the Industry 3.0. The Company intensively explored and boosted wisdom manufacturing in an effort to realize transferring from data warehouse to big data center in decision-making analysis, transformation from partial collaboration to overall optimization in the supply chain and transition from automation to intelligentization in production equipment through deep integration of new technologies such as the Internet, cloud computing and big data and whole supply chain.

The Company has constantly adopted a premium product development strategy featured by technological leadership, paid close attention to rapid growth in high-end manufacturing in China such as war industry, nuclear power, high-speed rail, maritime work and new energy vehicles, developed high-end products including ultra-high strength steel and oriented silicon steel, conducted research & development on more high-end new materials technologies, endeavored to transfer its principal business from iron & steel to materials, and enjoyed the economic benefit brought by high-end product structure. Listed as the most reliable value creation partner by customers, the Company spotlighted “from manufacturing to service” and “from China to global”, and through early vendor involvement, major customer director system, e-commerce trading platform, gave a quick response to complete marketing service system and rapid strategic layout of iron & steel service platform. Through worldwide marketing network, the Company provided customers with first-class products, technologies and service, satisfying the demand from domestic market while its products are exported to more than seventy countries and regions including Japan, South Korea, Europe and America.

2. Development Stage and Periodic Features of the Industry that the Company Involves and the Company’s Status in the Industry during the Reporting Period

Global economy has undergone a profound adjustment in 2015, with developed economies presenting an unstable recovery in general, obvious polarization of emerging economies and China’s economy in “New Normal”. National production of crude steel was 803.8 million tons in 2015, down by 2.3% compared to the same period of last year, which is the year-on-year drop for the first time since 1981. Apparent consumption of domestic crude steel was 700 million tons, down by 4.2% year-on-year. National investment in fixed assets (excluding agriculture) was RMB 53.16 trillion, nominally up by 5.6% year-on-year. Main downstream industries such as construction, machinery, automobile, energy, shipbuilding, household appliances were facing depressed demand and sluggish production. The oversupply was highlighted, and homogeneity competition was even worse.

The prices of ore, coke and steel scrap have respectively fallen by 39.4%, 33.3% and 45% in 2015, leading to a sharp decline in steel production cost. However, slump in steel price had much more impact on the sales revenue than that of price falling in raw materials on cost, which resulted in a huge loss among steelmakers. According to the statistics of China Iron and Steel Association (CISA), 101 large- and medium-sized steelmakers realized RMB -64.53 billion profit in 2015, RMB 87.12 billion less year-on-year, with 50.5% global loss rate, 34 more steelmakers bearing loss, RMB 81.72 billion in loss, representing RMB 61.52 billion more loss year-on-year.

The Company continued its technical leadership in 2015, conducted premium product strategy and maintained its leadership in high-end product market. The shares in domestic cold-rolled automotive sheet market and ultra-high strength steel market have both exceeded 50%. Market competitiveness of oriented silicon steel has been enhancing. The Company earned 45% market share in UHV AC/ DC engineering market, becoming the first domestic enterprise capable of manufacturing rolled clad plate in batches for accumulator at CAP1400 nuclear power plant. Meanwhile, the Company extended its overseas high-end product market, holding export ratio of 10% and more.

3. Highlights during the Reporting Period

- The world premiere of five new products including ultra-high strength medium manganese steel (1180Mpa) was realized. Three achievements including Development and Application of Pickling & Tandem Cold Mill Process Technology for High Grade Non-oriented Silicon Steel won the first prize of Metallurgical Science and Technology Progress Award; A Kind of Cold-rolled Galvanized Dual Phase Steel and Its Manufacturing Method and other two projects won Chinese Patent Award of Excellence.
The Company carried forward automotive sheet EVI and brand construction, and held the Third Baosteel EVI Forum and News Conference of BCB; Both cold-rolled automotive sheet and ultra-high strength steel have gained more than 50% domestic market share; Oriented silicon steel has gained up to 45% market share in UHV AC/ DC engineering, which made the Company the first domestic steel supplier who supplies non-oriented and oriented silicon steel to nuclear power sector.

The construction of Zhanjiang Steel Project progressed smoothly: No. 1 blast furnace tapped iron successfully on Sep. 26; Hot load test of steel-making plant succeeded on Sep. 28; 2250 hot rolling project realized hot load test run on Dec., 15 ahead of schedule.

The Company advanced its wisdom manufacturing to the extent that 1580 hot rolling intelligent workshop, as the exclusive pilot awarded among steel industry, has gained the qualification for 2015 intelligent manufacturing demonstration pilot from Ministry of Industry and Information Technology of the People’s Republic China.

The Company established Ouyeel Commerce Co., Ltd, with 8.88 million tons of annual e-commerce business volume and RMB 19.8 billion sales revenue realized, signed strategic cooperation agreement with 15 banks, with more than RMB 160 billion of line of credit, the highest among internet finance industry. “Bao Cloud” has been exclusively awarded the title of “2015 China Golden Service-The Most Influential Supplier in Cloud Computing”.

Total energy consumption continued the decline, with 60 thousand tons of standard coal less year-on-year; The Company, with its great effort on emission reduction, has overfulfilled its annual and “the Twelfth Five Year” emission reduction goal set by the government; 90 mw photovoltaic power station has been established and put into operation, with an estimated annual generating capacity of 70 million kilowatt hour.

The Company has overcome unfavorable factors such as declined profit and safeguarded the control over capital, with RMB 21.18 billion of annual net cash flow from operating activities and 47.8% asset-liability ratio.

II. Material Change in Major Asset of the Company in the Reporting Period

1. Change in Equity Asset

1) Establishment of Ouyeel Commerce and its branches

Traditional manufacturing industries like steel is facing rigorous operation problems while new economic power like Internet e-commerce is rising sharply. To cope with rigorous situation of steel industry and promote sustainable development, the Company revolved around the development strategy of “One Body Two Wings” and transformed “from manufacturing to service”, through integrating resources and business such as relevant transaction platform, technical service, payment settlement, financial service and big data analysis of the Company and branches of Baosteel Group, to build an integrated service platform for domestic steel transaction and service, which delivers tailor-made service to steelmakers and users and creates a new profit mode. The Company established Ouyeel Commerce and its branches through reorganization, establishment and merge.

Ouyeel Commerce was jointly incorporated in Feb., 2015 with registered capital of RMB 2 billion by the Company, along with Baosteel International, the Company’s wholly- owned subsidiary, as well as Baosteel Group, of which, the Company and Baosteel International subscribed 51% of stock equity with their 100% stock equity in Bsteel Online Co., Ltd as consideration of RMB 1.02 billion, integrating the restructuring of e-commerce transaction platform, technical service, payment settlement, financial service and big data analysis of the Company and branches of Baosteel Group, to build an integrated service platform for domestic steel transaction and service, which delivers tailor-made service to steelmakers and users and creates a new profit mode. The Company established Ouyeel Commerce and its branches through reorganization, establishment and merge.

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2) Non-public issuance of A-shares by Baosight

Baosight, a holding subsidiary of the Company, issued 27,493,010 non-public A-shares in Oct., 2015, with total net proceeds of RMB 1.155 billion less issuance cost. The Company subscribed non-public 15,258,621 A-shares with RMB 655 million as per its shareholding ratio in Baosight before the issuance. After this non-public issuance, the total share capital of Baosight is increased to RMB 392 million, of which the Company holds 55.5% shares.

3) Involvement in PetroChina’s pipeline integration project

Based on recorded asset evaluation value, the Company contributed the consideration of RMB 8.644 billion with its 12.8% shareholding in PetroChina Northwest United Pipeline Co., Ltd to PetroChina Pipeline Co., Ltd and held 3.52% stock equity in it.
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2. Change in Fixed Asset and Construction in Progress

RMB 8.17 billion has been added in fixed assets compared to that at the beginning of the year, of which, RMB 19.4 billion from construction in progress (mainly because of the transfer to fixed asset from Zhanjiang project), RMB 500 million from scrapped asset and RMB 10.57 billion from accrual of depreciation.

RMB 6.870 billion has been added in construction in progress than that at the beginning of the year, mainly because of the addition of RMB 7.22 billion in Zhanjiang Steel.

3. Overseas Assets

As of the end of 2015, the Company held RMB 14.41 billion of overseas assets, accounting for 6.2% of total assets.

(1) Development history of overseas state-owned assets

The Company, in 2005, through additional issuance, made an acquisition of stock equity of overseas marketing companies owned by Baosteel Group such as Baosteel America and Baosteel Europe, Bao-Trans and Bao-Island Enterprises Limited and preferred stock equity of Baovale Mineracao S.A. The Company has successively set up six overseas companies in joint venture or sole proprietorship since 2011 including Poly Pipe and Baosteel India to extend its capabilities in overseas manufacturing and processing service. As of the end of 2015, the Company has set up 14 subsidiaries at all levels and 6 joint-stock companies based in countries and regions such as USA, Japan, Germany, Singapore, Thailand and Hong Kong. Meanwhile, the Company has made USD 81.0154 million direct investment in its first-level overseas subsidiaries, involving steel trade and deep processing.

(2) Operation status of overseas state-owned assets

Overseas trading subsidiaries mainly include: HOWA, Baosteel Europe, Baosteel America, Baosteel Singapore and their subsidiaries; Overseas shipping subsidiaries mainly include: Bao-Trans; Overseas steel manufacturing and processing service companies mainly include: Poly Pipe, BGM and India Service Center.

(3) General information of oversea state-owned assets

As of the end of 2015, first level subsidiaries of the Company have RMB 14.41 billion of total assets, RMB 39.29 billion of operating revenue, RMB 3.67 billion of owner’s equity, RMB 470 million of total profit and RMB 360 million of net profit, with 9.7% of return on equity.

III. Analysis of Core Competitiveness during the Reporting Period

In 2015, the Company overcame adverse factors such as insufficient external demand, declined steel price and RMB exchange rate reform, successfully kept the best operating profit among domestic listed steelmakers through greater efforts in innovation, product structure adjustment, continuous internal development, premium product strategy as before and other initiatives.

1. Innovation in technologies

More efforts in debut product R&D for competitive advantages. The Company finished trial production of 5 new products and put them into market, including new generation advanced ultra-high strength steel and high-induction oriented silicon steel. In the meantime, the Company endeavored to market these debut products to the extent that the technical advantages would be transformed into high-profitability. More than 10,000 tons of debut products were supplied in 2015, resulting in good economic benefit.

2. Manufacturing capabilities

The Company proceeded with its major project construction in a safe, premium and efficient manner. Ignition of Zhanjiang No.1 blast furnace and successful hot load trial run of steel-making and 2250 hot rolling project have written a new chapter for second enterprising and transformation development. Projects have been successively put into operation such as overhaul of Headquarter Phase I coke oven, comprehensive revamping of No.2 steel-making plant’s hot metal pretreatment. Projects have been proceeded as planned on site, such as overhaul and serial revamping in raw materials and iron-making area, No.3 sintering plant overhaul, and new automotive sheet recoiling project of cold rolling 1550 unit.

Focusing on automobile market, the Company has added several production lines: cold rolling 2030 unit has added a new single stand reversing mill, which has been put into operation, and succeeded in hot load test run of new galvanizing project; 4#GA for BNA has been put into operation, which met the increasingly improving demands from the automobile industry at home and abroad on automotive sheet and further boosted the Company's market competitiveness.
3. User service

The Company carried out customized EVI and automotive sheet brand campaign for major auto users, explored and extended EVI projects for industries other than automobile, therefore forming respective EVI progress modes for six industries. The Company concerned for customers’ experience, attempted to apply the concept and method of wisdom manufacturing into supply chain synergy, strengthened and constantly improved Baosteel’s competitive advantages in security and safeguard of supply chain. Moreover, the Company expanded Baosteel mobile application for marketing and added new functions such as work information, user dynamic tracking for Group customers, which, as a new edition in return, can facilitate users’ experience and interactivity.

4. Two wings

Ouyeel Commerce, as e-commerce platform, realized 8.88 million tons of total steel transaction and RMB 19.8 billion of sales revenue in 2015. As its business mode started to function much better than before, with expanding service radius and a nationwide service network, Ouyeel Commerce has basically finished its strategic layout, laying a solid foundation for future development.

Baosight Software energetically advanced cloud computing, industry 4.0, big data platform, and e-commerce platform, and made breakthrough in sectors such as wisdom steel manufacturing solution, unmanned business, robot business, e-service platform for IPPF supplies and financial service platform. “Bao Cloud” won the title of “2015 China Gold Service -the Most Influential Service Provider in the Field of Cloud Computing”.

5. Environmental protection control

With the enforcement of strictest environmental protection law in history, the Company actively explored management method based on improved basic control capability, made special planning for urban steel mill and vigorously conceived countermeasures to tackle environmental protection crisis and risk. Utilizing online environmental monitoring, the Company introduced dynamic emission yield index and carried forward engineering emission reduction, management emission reduction, technical support, environmental protection equipment classification management and others. All environmental protection indexes have been controlled as annual objectives required and main indexes have been continuously improved.

6. Brand, credit and staff

The Company in 2015 took “Creativity Changes Life” as starting point for brand construction and promoted 5 brands with Baosteel automotive sheet brand as the focus. Through organizing Baosteel automotive sheet technology show, participating in international automotive exhibition, planning “Lively Innovation, Travel Greener” advertising video and setting up official wechat account and other forms, the Company explored new mode for brand construction, planned brand communication by multi-platform linkage, selectively chose media and designed efficient release interval and three-dimensional communication activities to spread the idea of “Creativity Changes Life” among and outside the Company.