







REPORT OF THE BOARD OF DIRECTORS

The Board of Directors (“the Board”) has pleasure in presenting their report together with the audited accounts of the Company for the year ended 31st December 2003 to the shareholders.

General Meeting

During the year, the Company had strictly complied with the relevant laws, regulations and the requirements of the Articles of Association of the Company. An Annual General Meeting and two Extraordinary General Meetings were held, the details of which are as follows:

1. The Annual General Meeting of the Company was held on 16th April 2003. At the meeting, the report of the Board, the audited accounts and the auditors’ report, profit distribution proposal and the distribution of final dividends for the year 2002 were considered and approved; members of the third Board and shareholders’ representatives to the third Supervisory Committee of the Company were elected; the Rules of Procedures for General Meetings, the Rules of Procedures for Board of Director’s Meetings, the Rules of Procedures for Supervisory Committee’s Meetings and the System for Independent Directors were approved as ordinary resolutions; and the amendments to the Company’s Articles of Association were considered and approved as a special resolution.
2. The General Meetings for Holders of H shares and Domestic shares of the Company were held on 16th April 2003. These two General Meetings have considered and approved the Company’s issuance of additional Renminbi denominated ordinary shares (A Shares) to the public to increase capital on the relevant principal terms and conditions.
3. The Extraordinary General Meeting of the Company was held on 16th April 2003. At the meeting, the following proposals were considered and approved as special resolutions:
 1. the Company’s issuance of additional Renminbi denominated ordinary shares (A Shares) to the public to increase capital on the relevant principal terms and conditions; 2. the use of proceeds to be raised from issuance of additional A shares set out in resolution 1 passed at the General Meeting; 3. the feasibility report for the steel strip project of Chongqing Iron & Steel Company Limited; 4. amend the Articles of Association of the Company; 5. the authorisation of the Board to handle, at their own discretion, any matters related to the issuance of additional A Shares; 6. the undistributed profits of the Company generated before the issuance of additional A Shares to be shared among its existing and new shareholders after the completion of the issuance of additional A Shares; 7. Explanation on the Use of the Previous Proceeds; 8. approved the resolution in relation to ratifying the change in the use of proceeds from the issuance of H shares.

Details of the above resolutions at the General Meetings have been published in the “Wen Wei Po” and “The Standard” and “China Securities Journal” dated 17th April 2003.



REPORT OF THE BOARD OF DIRECTORS *(continued)*

The Meeting of the Board of Directors

In accordance with the provisions of the Articles of Association of the Company, the second Board expired on 16th April 2003, and the members of the third Board were elected at the Annual General Meeting 2002 held on the same day. The third Board comprises six executive directors and three independent non-executive directors. All directors undertake their obligations in accordance with laws and seriously implemented the resolutions passed at shareholders' meeting in a proactive manner.

During the year, the Board had convened five meetings:

1. On 27th February 2003, the eighth meeting of the second Board of the Company was held, at which the report, annual results announcement and amendments to the Articles of Association for the year 2002; the Rules of Procedures for General Meetings, the Rules of Procedures for Board of Director's Meetings and the System for Independent Directors were approved as ordinary resolutions; the amendments to the Company's Articles of Association were considered and approved. Various rules and regulations for the Board were considered and approved for implementation, which included Rules for the General Manager, Rules for the Secretary to the Board, Implementing Rules for Connected Transactions, Internal Audit System, Financial and Accounting System, Internal Fund Management System, Decision-making System for Providing Security for Foreign Parties, Procedures for Investment Decision Making, System for the Management of Information Disclosure and Procedures for the Management of Proceeds. The proposal to set up an audit committee was approved and duties thereof were defined. Proposals such as the qualifications, proposed plan, use of proceeds, accumulation of profits of the Company to be shared by existing and new shareholders upon completion of the issuance in respect of the issuance of additional A shares were approved.
2. On 16th April 2003, the first meeting of the third Board of the Company was held, at which the chairman of the third Board was elected; the chairman and members of the second Audit Committee were appointed; the proposal to extend the operating terms of 13 branches of the Company was considered and approved; and members of the audit office were appointed.
3. On 21st August 2003, the second meeting of the third Board of the Company was held, at which resolutions such as the interim financial accounts, the interim results announcement and interim report for the year 2003 as well as the proposal on the establishment of an Ad Hoc Committee of the Board and Work Procedures for Ad Hoc Committee of the Board were considered and approved.
4. On 22nd August 2003, the Company convened the third meeting for the third Board by way of telecommunications. Resolution in relation to the renovation and expansion of the project of sintering plant workshop was approved.



REPORT OF THE BOARD OF DIRECTORS *(continued)*

The Meeting of the Board *(continued)*

- On 23rd December 2003, the Company convened the third meeting for the fourth Board by way of telecommunications. At the meeting, the acquisition of part of the leased plants and equipment owned by the Holding Company at a consideration of Rmb20,164,300, was considered and approved by the Company. The relevant announcement was published in Hong Kong newspapers on 24th December 2003.

Audit Committee

The first Audit Committee of the Company was set up on 19th April 2000 and expired on 16th April 2003. On the same day, the first meeting of the third Board appointed the chairman and members of the second Audit Committee.

Two meetings of Audit Committee were held during the year:

- On 26th February 2003, the fifth meeting of the first Audit Committee was held at which resolutions concerning various matters including the audited accounts of 2002 and report of the appointment of auditors, matters of internal control, the Company's connected transactions in 2002 and the establishment of internal audit office by the Company were considered and approved.
- On 19th August 2003, the Company convened the first meeting of the second Audit Committee. At the meeting, the interim financial accounts of the Company in 2003 and interim report were considered and approved.

Principal Business

The principal business of the Company is the manufacture and sale of steel products such as medium-gauge steel plates, steel sections and wire rods. As over 90% of the turnover and operating profits of the Company are derived from the business of steel products and its by-products, no segment information for businesses is presented.

All the Company's sales and operations in 2003 were carried out in the PRC, therefore, no geographical segment information is presented.



REPORT OF THE BOARD OF DIRECTORS *(continued)*

Results and Appropriations

Results and appropriations of the Company for the year ended 31st December 2003 prepared in accordance with the accounting principles generally accepted in Hong Kong are set out in the consolidated profit and loss account on page 63 of the Annual Report.

The Company has not declared any interim dividends for 2003.

In 2003, the Company's operating results achieved a substantial growth because the Company overcome negative factors such as shortage of resources and navigation suspension in the Three Gorges. The Company made full use of the favourable market conditions to increase its production capacity, improve the quality of its products and properly adjust its selling strategies. The profit attributable to shareholders amounted to Rmb977,039,000. The Board recommends to distribute final dividend of Rmb0.20 per share for the year of 2003, representing a total of Rmb212,789,000.

In accordance with documents no. 372 (1999) issued by State Administration of Foreign Exchange and State Administration of Taxation, the final dividend for the year of 2003 distributed by the Company are exempt from tax.

Distributable Reserves

Distributable reserves of the Company as at 31st December 2003, as determined under PRC law and regulations, amounted to Rmb1,394,753,000 (2002: Rmb649,159,000).

Financial Summary

A summary of the results and the assets and liabilities of the Company for the past five years are set out on page 9 of the Annual Report.



REPORT OF THE BOARD OF DIRECTORS *(continued)*

Share Capital

The structure of the Company's share capital as at 31st December 2003 was as follows:

Share type	Number of shares with par value of Rmb1 each (in thousand shares)	Percentage to the Company's total issued share capital (%)
Unlisted State-owned shares	650,000	61.09
H shares listed in Hong Kong	413,944	38.91
Total	1,063,944	100.00

During the year, the Company did not issue any equity securities and there were no changes in the share capital structure.



REPORT OF THE BOARD OF DIRECTORS *(continued)*

H Share Information:

Details of the issue of the Company's H shares listed in Hong Kong since the establishment of the Company in August 1997 are as follows:

Pursuant to initial public offering:

Date of issue:	15th October 1997
Place of listing:	Hong Kong
Issue price:	HK\$1.71
Number of shares issued:	410,000,000 shares
Date of listing:	17th October 1997

Pursuant to over-allotment option

Date of issue:	6th November 1997
Place of listing:	Hong Kong
Issue price:	HK\$1.71
Number of shares issued:	3,944,000 shares
Date of listing:	10th November 1997

Number of H shares approved for listing: 413,944,000 shares

During the year:	
Highest trading price	HK\$4.425per share
Lowest trading price	HK\$0.82 per share
Closing price on the last trading day	HK\$4.125per share
Total transaction volume	3,826,070,000 shares



REPORT OF THE BOARD OF DIRECTORS *(continued)*

Number of Shareholders

At 31st December 2003, the Company's total number of shareholders was 218, which included one shareholder of state-owned shares and 217 shareholders of H shares.

Substantial Shareholders' Interest in the Shares of the Company

At 31st December 2003, the register of substantial shareholders maintained under Section 336 of the Securities and Future Ordinance ("SFO") showed that the Company had been notified of the following substantial shareholders' interests, being 5% or more of the Company's issued share capital:

Name of shareholder	Class of shares	Number of shares held (in thousand shares)	Percentage to total issued share capital held(%)
Chongqing Iron & Steel Company (Group) Limited	State-owned share	650,000	61.09
HKSCC Nominees Limited	H share	404,873.9	38.05

Purchase, Sale or Redemption of the Company's Securities

As at 31st December 2003, the Company has not redeemed any of its issued securities. During the year, the Company has not purchased, or sold any of the Company's securities.

Pre-emptive Rights

There is no provision for pre-emptive rights under PRC Laws and the Company's Articles of Association.

Use of Proceeds from the New Issue

The proceeds raised from the insurance of H shares of the Company in 1997 have been fully utilised at the end of 31st December 2000.



REPORT OF THE BOARD OF DIRECTORS *(continued)*

Directors and Supervisors

On 16th April 2003, the Company convened the Annual General Meeting and elected the third Board of the Company and supervisors of the Company. Directors and supervisors of the Company who held offices during the year ended 31st December 2002 were as follows:

Directors:

Mr. Tang Min Wei	Chairman	Re-elected on 16th April 2003
Mr. Yuan Jin Fu	Director	Appointed on 16th April 2003
Mr. Chen Shan	Director	Re-elected on 16th April 2003
Mr. Yang Zhi Wei	Director	Appointed on 16th April 2003
Mr. Sun Yi Jie	Director	Appointed on 16th April 2003
Mr. Tu De Ling	Director	Appointed on 16th April 2003
Ms. Zeng Chao Bi	Director	Resigned on 16th April 2003
Mr. Dong Rong Hua	Director	Resigned on 16th April 2003
Mr. Pan Xiang Yu	Director	Resigned on 16th April 2003
Mr. Wang Xiang Fei	Independent Non-executive Director	Re-elected on 16th April 2003
Mr. Wu Zhong Fu	Independent Non-executive Director	Re-elected on 16th April 2003
Mr. Sun Yu	Independent Non-executive Director	Appointed on 16th April 2003

Supervisors:

Mr. Zhu Jian Pai	Chairman of Supervisory Committee	Re-elected on 16th April 2003
Mr. Huang You He	Supervisor	Re-elected on 16th April 2003
Mr. Wu Zi Sheng	Supervisor	Appointed on 16th April 2003
Ms. Yuan Xue Bing	Supervisor	Re-elected on 16th April 2003
Ms. Liu Xiu Ying	Supervisor of staff's representative	Re-elected on 13rd February 2003
Mr. Su Quan Lin	Supervisor	Resigned on 16th April 2003

In accordance with Articles 93 and 121 of the Articles of Association of the Company, the term of office of directors and supervisors is three years commencing from the date of appointment or re-election, renewable upon re-appointment or re-election.



REPORT OF THE BOARD OF DIRECTORS *(continued)*

Changes of Directors, Supervisors and Other Senior Management of the Company as of the Reporting Date of the Company:

1. On 16th April 2003, the Company convened the Annual General Meeting and elected the third Board. The Board comprises six executive directors and three independent non-executive directors. Mr. Tang Min Wei, Mr. Chen Shan, Mr. Wang Xiang Fei, Mr. Wu Zhong Fu were re-elected, whereas Mr. Yuan Jin Fu, Mr. Yang Zhi Wei, Mr. Sun Yi Jie, Mr. Tu De Ling, Mr. Sun Yu were elected. Besides, Mr. Pang Xiang Yu, Mr. Dong Rong Hua and Ms. Zeng Chao Bi resigned from their positions.
2. On 16th April 2003, the Company convened the Annual General Meeting and elected the third Supervisory Committee. The Supervisory Committee comprises five supervisors. Mr. Zhu Jian Pai, Mr. Huang You He, Ms. Yuan Xue Bing were re-elected. Ms. Liu Xiu Ying was re-elected on 13rd February 2003. Mr. Wu Zi Sheng was appointed. Meanwhile, Mr. Xu Chuan Lin resigned from his position.
3. To strengthen corporate governance structure, the Company's chairman, Mr. Tang Min Wei resigned as general manager on 8th May 2003 and Mr. Liu Jia Cai was appointed by the Board as general manager of the Company.
4. On 13th May 2003, the Board appointed Mr. Sun Yi Jie, Mr. Yang Zhi Wei, Mr. Chen Ya Xiong as deputy general managers of the Company and Mr. Tu De Ling as the in charge of the Company's finance department (chief accountant) on the nominations by general manager, Mr. Liu Jia Cai. Furthermore, Mr. Chen Shan no longer assumed the post of deputy general manager.
5. On 15th July 2003, the Board of Directors approved a written proposal of the termination of the appointment of Mr. Chen Ya Xiong as the Company's deputy general manager.
6. On 1st December 2003, due to the work changes of Mr. Liu Jia Cai, he no longer assumed the post of general manager. The Board appointed Mr. Yang Zhi Wei as the general manager of the Company.
7. On 8th December 2003, as proposed by Mr. Yang Zhi Wei, the general manager of the Company, the Board appointed Mr. Qiang Bai Qian as the deputy general manager of the Company.
8. On 8th January 2004, as proposed by Mr. Yang Zhi Wei, the general manager of the Company, the Board appointed Mr. Xu Gang and Mr. Wu Zi Sheng as the deputy general manager of the Company. Mr. Xu Gang was also appointed as the chief engineer of the Company. At the same time, Mr. Sun Yi Jie resigned as chief engineer of the Company.



REPORT OF THE BOARD OF DIRECTORS *(continued)*

Directors' and Supervisors' Service Contracts

Directors and supervisors of the Company have entered into service contracts with the Company, which will expire on 16th April 2006. Either party may terminate the service contract with three months notice.

Independent non-executive directors of the Company have not entered into service contracts with the Company.

Directors' and Supervisors' Interests in the Shares of the Company or any Associated Corporation

As at 31st December 2003, the interests of the directors and supervisors in the shares of Duoli Real Estate Co., Ltd. (a subsidiary of the Holding Company renamed upon reorganisation following the transfer of the Company's shares in Hengda to the Holding Company in December 2002. Please refer to the Company's 2002 Annual Report for details of asset reorganisation) of Chongqing Iron & Steel Group as recorded in the register maintained under Section 352 of the SFO or as notified to the Company were as follows:

Name	Family's interest Total
Yuan Jin Fu	2,400 shares
Chen Shan	800 shares
Yang Zhi Wei	800 shares
Sun Yi Jie	800 shares
Tu De Ling	800 shares
Yuan Xue Bing	800 shares
Wu Zi Sheng	2,400 shares

Save as disclosed above, none of the directors, supervisors or their associates had any interest in the shares of the Company or its associated corporations at 31st December 2003.

For the year ended 31st December 2003, none of the directors or supervisors or their spouses or children under 18 years of age has been granted by the Company the rights to subscribe for the Company's shares.

At no time during the year was the Company, its fellow subsidiaries or its Holding Company a party to any arrangements to enable the directors or supervisors of the Company to acquire benefits by means of the acquisition of shares in, or debentures of, the Company or any other body corporate.



REPORT OF THE BOARD OF DIRECTORS *(continued)*

Directors' Interests in Contracts

No contracts of significance in relation to the Company's business to which the Company, its fellow subsidiaries or its Holding Company was a party and in which a director or supervisor of the Company had a material interest, whether directly or indirectly, subsisted at the end of the year or at any time during the year.

Material Contracts with the Holding Company

1. Service and Supply agreement

Under the service and supply agreement dated 29th September 1997, the Holding Company has agreed to supply or to procure its subsidiaries (the Holding Company and its subsidiaries excluding the Company are hereinafter collectively referred to as the "Holding Company Group") to supply certain equipments and materials and provide certain welfare and support services to the Company; and the Company has agreed to supply or to procure its subsidiary to supply certain materials and provide certain services including the supply of water, electricity and gas to the Holding Company Group. The agreement was effective from 29th September 1997 for a term of 10 years. The consideration payable for these services is based, if applicable, on market prices or government-regulated prices, as provided for in the agreement.

2. Lease agreements

Under the lease agreements dated 14th August 1997 and 13th August 1997, as amended by a supplementary agreement dated 29th September 1997, the Company and Hengda lease land on which the Company's plants are located from the Holding Company for a term of 50 years from 14th August 1997 and 13th August 1997 respectively. For the years 1998 to 2000, the total rental was Rmb11,994,000 per annum. Thereafter, the rent will be adjusted subject to a maximum increment of 10% of the latest applicable rental amount every three years by negotiation between the Company and the Holding Company.

On 12th January 2001, the Holding Company entered into supplementary agreements with the Company and Hengda respectively in respect of the adjustment on the rent for the lease of land. The rent for the lease of land from the Holding Company was increased at 10% based on the latest applicable rental amount. The annual rent amount paid by the Company was approximately Rmb13,200,000 for the years 2001 to 2003.



REPORT OF THE BOARD OF DIRECTORS *(continued)*

Material Contracts with the Holding Company *(continued)*

On 8th December 2002, the Company and the Holding Company entered into the Lease Agreement to rent the land with an area of 216,430 square metres, which is currently occupied by Henda, for a term of 45 years. The rental is Rmb1,028,475 per annum and such rental may be adjusted after 1st January 2004 and for at least every three years after the last rent adjustment. Any adjustment made shall not exceed 10% of the rent paid by the Company at that time. Waiver from strict compliance with the disclosure requirements of the Rules Governing the Listing of Securities (the "Listing Rules") has been granted by The Stock Exchange of Hong Kong Limited (the "Stock Exchange") in respect of the lease agreement, and the Company has made an announcement on newspapers in Hong Kong on 12th December 2002.

Connected Transactions

1. Details of the related party transactions entered into by the Company during the year ended 31st December 2003 are set out in note 23 to the Accounts on pages 95 to 97. Such transactions also constituted connected transactions under the Listing Rules of the Stock Exchange.
2. The connected transactions discloseable according to Chapter 14 of the Listing Rules are set out below:
 - (1) Connected transactions that have been granted waivers

Connected transactions between the Company and the Holding Company Group described in paragraphs (2), (4) to (9) on pages 76 to 80 of the Prospectus and page 34 to 35 of this Annual Report (the "Transactions") have been waived by the Stock Exchange from strict compliance with the provisions of Chapter 14 of the Listing Rules, provided that the conditions as set out in the letters from the Stock Exchange dated 28th November 1997 and 24th December 2002 (details of which are set out in paragraph (3) headed "Land leasing agreements" above) are fulfilled.

The independent non-executive directors of the Company have reviewed the Transactions during the year and have confirmed that:

- (a) The Transactions have been entered into in the ordinary course of business of the Company;



REPORT OF THE BOARD OF DIRECTORS *(continued)*

Connected Transactions *(continued)*

- (1) Connected transactions that have been granted waivers *(continued)*
 - (b) The Transactions have been entered into on normal business terms (i.e. terms determined with reference to transactions of a similar nature or entered into by similar companies in the PRC) or, where there were no available comparisons, on terms that were fair and reasonable so far as the shareholders of the Company are concerned;
 - (c) The Transactions were entered into: (1) in accordance with the terms of the agreements that governed the Transactions, or (2) where there was no such agreement, on terms no less favourable than those available to third parties;
 - (d) The Transactions were in compliance with the conditions of the relevant waivers granted.
- (2) Loan guarantee provided by the Holding Company

In 1998, the Holding Company pledged its 650,000,000 state-owned legal shares of Rmb1 each in the Company for the banking credit facility of the Company, with the highest credit facility amounted to Rmb650,000,000. Its effective period started from 12th October 1998 to 12th October 2003.

With discussions between the bank and the Holding Company and the Company, the above pledge of the state-owned legal shares had been released in December 2002, and part of the Company's fixed assets, and land held by the Holding Company has been pledged and guaranteed for the loan instead. With the above changes, the highest credit facilities for the loan amounted to Rmb407,420,000. On 31st December 2003, the short-term and long-term bank loans used by the Company as approved by the aforesaid credit facilities are Rmb86,000,000 (31st December 2002: Rmb197,330,000) and Rmb20,000,000 (31st December 2002: Rmb165,000,000) respectively.

In addition, on 31st December 2003, the short-term and long-term bank loans of the Company are Rmb409,900,000 (31st December 2002: Rmb395,170,000) and Rmb595,000,000 (31st December 2002: Rmb70,000,000) respectively, and both are guaranteed by the Holding Company.



REPORT OF THE BOARD OF DIRECTORS *(continued)*

Designated Deposits and Overdue Time Deposits

As at 31st December 2003, the Company had not placed any designated deposits with any financial institutions in the PRC, nor had it failed to collect any time deposits upon maturity during the period.

Pledge of Assets and Contingent Liabilities

The Company has pledged certain of its fixed assets as securities for bank loans. As at 31st December 2003, the net book value of the Company's pledged fixed assets amounted to Rmb368,014,000 (31st December 2002: Rmb407,866,000).

As at 31st December 2003, the Company had no contingent liabilities.

Foreign Exchange Risk

During the year, the Company had no foreign currency borrowings or deposits. Accordingly, there was no foreign exchange risk for the Company.

Material Litigation

During the year, the Company had not involved in any significant litigation or arbitration.



REPORT OF THE BOARD OF DIRECTORS *(continued)*

Significant Events

1. On 8th April 2003, the Board approved a written proposal of the Introduction of Cold Rolling and Flattening Mechanical Control System to the Steel Strip Project and approved an investment of Rmb15.20 million (of which includes US\$1.47 million) for the Introduction of Cold Rolling and Flattening Mechanical Control System as ancillary equipment for the Steel Strip Project.
2. On 18th June 2003, the Board approved a written proposal of the Building of Continuous Casting Machine No. 5 for Steel Plate Slabs for Steel Smelter, the Overhaul to and Expansion of Capacity of Medium-Gauge Steel Plate Plant, the Building of LF Furnace No. 2 and On-Line Multifunctional Refining Treatment Station for Steel Smelter and the Building of Electrical Blower No. 3. The amount approved for the Expansion of Continuous Casting Machine No. 5 for Steel Plate Slabs for Steel Smelter was Rmb40 million; for the Overhaul to and Expansion of Capacity of Medium-Gauge Steel Plate Plant was Rmb183.78 million; for the Expansion of LF Furnace No. 2 and an On-line Multifunctional Refining Treatment Station was Rmb17.35 million; and for the Expansion of the Electrical Blower No. 3 was Rmb33.09 million.
3. On 2nd July 2003, the Board passed a written resolutions in relation to the establishment of cold rolling by the Company and approved the Company to set up cold rolling plant on 1st July 2003.
4. On 9th November 2003, the Company completed its overhaul of the iron refinery 620m³ blast furnace and started ignition, and successfully produced the first furnace of iron water.
5. On 1st December 2003, the Board appointed Mr. Tang Min Wei as the chairman of the Strategic Committee, and appointed Mr. Yang Zhi Wei, Mr. Sun Yi Jei, Mr. Tu De Lin and Mr. Wu Zhong Fu as the members of the Strategic Committee; appointed Mr. Sun Yu as the chairman of the Salary and Remuneration Review Committee, and appointed Mr. Yuan Ji Fu, Mr. Chen Shan, Mr. Wang Xiang Fei and Mr. Wu Zhong Fu as the members of the Salary and Remuneration Review Committee.



REPORT OF THE BOARD OF DIRECTORS *(continued)*

Promotion of the Additional Issuance of A Shares Proactively

On 16th April 2003, a resolution in relation to the issuance of A Shares of the Company was passed at the General Meeting of the Company. In June 2003, with its qualification for listing was approved, the Company formally submitted the application of issuance of A shares to the China Securities Supervisory Committee.

Management Contract

No contracts concerning the management and administration of the whole or any substantial part of the business of the Company were entered into or existed during the year.

Fixed Assets

Details of the movements in fixed assets of the Company during the year are set out on page 81 of the Annual Report.

Reserves

Movements in the reserves of the Company during the year are set out on pages 87 to 88 of the Annual Report.

Bank Loans and Other Loans

Details of the Company's bank and other loans are set out on pages 86, 89 and 90 of the Annual Report.

Interest Capitalisation

The amount of interest capitalised by the Company during the year is set out on page 77 of the Annual Report.



REPORT OF THE BOARD OF DIRECTORS *(continued)*

Staff Retirement and Benefits Scheme

Details of the Company's staff retirement and benefits scheme are set out on page 72 of the Annual Report.

Sale of Staff Quarters

For the year ended 31st December 2003, the Company had not sold any quarters to its employees, nor had it incurred any expenses as a result of the Holding Company's sale of quarters to the Company's employees.

Financial Arrangement of Housing Policy Reform

According to the document CZ [2000] No. 295 issued by the Ministry of Finance of the PRC on 6th September 2000 "Notice on the issues of the accounting treatment with respect to the reform on enterprises' staff housing system", all state-owned enterprises other than those in the financial services industry should terminate the physical allocation of staff quarters and implement the staff housing welfare fund system. These enterprises are also required to pay a one-off housing subsidy in cash to those staff who joined the work force prior to 31st December 1998 and have yet to receive physical allocation of staff quarters. The document required provincial and municipal governments to take responsibility for setting out the detailed regulations with respect to the timing and procedures for the implementation of the policy as required by the above document.

Prior to the establishment of the Company, the Holding Company had changed its housing scheme and implemented the housing welfare fund system in accordance with the requirements as stipulated in the document YZGF [1994] No. 05 issued by the Housing Policy Reform Leadership Committee of the Chongqing Finance Bureau in 1994. The Holding Company and its staff each contributes to the staff housing welfare fund based on a percentage of the staff salaries. The staff housing welfare fund is owned by the staff and administered by the Housing Fund Administrative Committee in Chongqing. After the Restructuring in 1997, the Company has been making contributions to the staff housing welfare fund in accordance with the abovementioned document.



REPORT OF THE BOARD OF DIRECTORS *(continued)*

Financial Arrangement of Housing Policy Reform *(continued)*

As at the date of this report, the Chongqing Finance Bureau has not yet issued any detailed arrangements and regulations for the implementation of the policy as required by the above document CZ [2000] No. 295. In the event that the Chongqing Finance Bureau implements the document CZ [2000] No. 295 mentioned above, the Company estimates that the housing subsidy in connection with those employees who joined the Company prior to 31st December 1998 and have yet to receive physical allocation of staff quarters to be approximately Rmb6 million. The Holding Company has undertaken to assume the liabilities that may arise as mentioned above, and will directly pay the relevant housing subsidy to those qualified employees.

In view of the above, the Company has not provided for any housing subsidy in the accounts for the year ended 31st December 2003.

Human Resources and Staff Remunerations

As at 31st December 2003, the Company had 11,473 employees, including 9,699 production operators, 826 technical staff and 948 management staff.

During the year, the staff cost of the Company amounted to Rmb489,705,000 (2002: Rmb398,989,000), representing an increase of 22.74% from last year.

During the year, 7,087 staff were trained to improve production efficiency, representing 60.14% of total staff.

Major Customers and Suppliers

The Company's sales to the five largest customers together account for less than 30% of the Company's gross sales amount.

The percentage of the Company's purchases attributable to major suppliers is as follows:

Percentage of purchases attributable to the Company's largest supplier	12.19%
Percentage of purchases attributable to the Company's five largest suppliers	31.63%

The Company's five largest suppliers include two fellow subsidiaries.



REPORT OF THE BOARD OF DIRECTORS *(continued)*

Major Customers and Suppliers *(continued)*

Except for the above, none of the Company's directors, supervisors, their associates or any shareholders (which to the knowledge of the directors owns more than 5% of the Company's share capital) has an interest in the above major suppliers.

Policy of Corporate Income Tax

No Hong Kong profits tax has been provided as the Company had no taxable profits in Hong Kong for the year (2002: nil).

The Company was established as a foreign investment enterprises in the cities along the Yangtze River. In accordance with the stipulations on the "Notice in relation to the State Administration of Tax's policies on taxation in further opening up China's boarder, coastal, continental and river provincial cities" (State Taxation Issue [1992] no.218), the Company's original corporate income tax rate is 24%. In April 2003, the Company received approvals (Yu State Taxation Issue Document [2003] no. 57) and (DaDuKou State Taxation Issue Document [2003] no. 8) from related taxation authorities in relation to the Company's entitlement to enjoy the "Go-West" corporate income tax preferential policies. In accordance with these approvals, the Company is entitled to enjoy the "Go-West" corporate income tax preferential policies during the period between 2001 and 2010, and the corporate income tax rate is decreased to 15%.

In addition, in accordance with an approval document issued by the Ministry of Foreign Trade and Economic Cooperation of the PRC on 7th December 1998 and the tax registration certificate received by the Company on 31st August 1999, the Company's status has been changed to that of the joint stock company with foreign investment. In accordance with Article 8 of the Income Tax Law of the PRC Enterprises with Foreign Investment and Foreign Enterprises, enterprises with foreign investment engaged in production business activities are entitled to two years exemption from income tax followed by three years of 50% reduction in income tax commencing from the first profitable year. The year ended 31st December 2003 is the Company's fourth profitable year after the change; accordingly, income tax has been provided at 50% of the income tax rate (i.e. 7.5%) on its estimated taxable profits for the year (2002: 7.5%).



REPORT OF THE BOARD OF DIRECTORS *(continued)*

Policy of Corporate Income Tax *(continued)*

In 2000, 2001 and 2002, the Company purchased certain domestic manufactured equipments. In accordance with Cai Shui Zi [2000] No. 49 "The Notice concerning the Reduction in Corporate Income Tax for Purchase of Domestic Manufactured Equipments by Enterprises with Foreign Investment and Foreign Enterprises" issued by the Ministry of Finance and State Tax Bureau, part of the purchase costs of the domestic manufactured equipments could be utilised to reduce the Company's corporate income tax.

In accordance with the approval letters (DDKGSH [2003] No. 4 and No.5) issued by State Tax Bureau in Dadukou District, Chongqing, with respect to the application for income tax reduction lodged by the Company relating to the purchase of domestic manufactured equipments in 2000, 2001 and 2002, the total tax reduction that the Company is entitled amounted to Rmb102,790,000. As the Company was exempted from income tax for 2000 and 2001, Rmb27,115,000 of the above tax deductible amount is utilised to offset the Company's income tax liability for the year ended 31 December 2002, and RMB75,675,000 has been utilised to offset the Company's income tax liability for the year ended 31st December 2003.

Code of Best Practice

Throughout the year, the Company was in compliance with the Code of Best Practice as set out in the Listing Rules.

Auditors

The accounts have been audited by PricewaterhouseCoopers who retire and, being eligible, offer themselves for re-appointment.

By Order of the Board
Tang Min Wei
Chairman

Chongqing, the PRC
11th March 2004