PRICEWATERHOUSECOOPERS

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PricewaterhouseCoopers
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Central, Hong Kong

AUDITORS' REPORT TO THE SHAREHOLDERS OF
CHONGQING IRON AND STEEL COMPANY LIMITED
(incorporated in the People's Republic of China with limited liability)

We have audited the financial statements on pages 60 to 112 which have been prepared in accordance with accounting principles generally accepted in Hong Kong.

Respective responsibilities of directors and auditors

The Company's directors are responsible for the preparation of financial statements which give a true and fair view. In preparing financial statements which give a true and fair view it is fundamental that appropriate accounting policies are selected and applied consistently.

It is our responsibility to form an independent opinion, based on our audit, on those financial statements and to report our opinion solely to you, as a body, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

Basis of opinion

We conducted our audit in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the circumstances of the Company, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance as to whether the financial statements are free from material misstatement. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements. We believe that our audit provides a reasonable basis for our opinion.

Opinion

In our opinion, the financial statements give a true and fair view of the state of affairs of the Company as at 31st December 2005 and of the profit and cash flows of the Company for the year then ended and have been properly prepared in accordance with the disclosure requirements of the Hong Kong Companies Ordinance.

PricewaterhouseCoopers
Certified Public Accountants

Hong Kong, 30th March 2006

BALANCE SHEET
As at 31st December 2005

	Note	As at 31st December 2005 Rmb'000	2004 Rmb'000
ASSETS			
Non-current assets			
Property, plant and equipment	5	**5,054,737**	4,038,633
Land use right	6	**27,290**	27,666
Available-for-sale financial asset	7	**5,000**	5,000
Deferred income tax assets	8	**2,493**	9,775
Trade and other receivables	10	**71,600**	38,773
		5,161,120	4,119,847
Current assets			
Inventories	9	**1,849,341**	1,541,267
Trade and other receivables	10	**636,878**	577,888
Prepayment for income tax		**20,378**	—
Bank deposits with maturity over 3 months and restricted cash	11	**13,342**	227,134
Cash and cash equivalents	12	**451,220**	734,698
		2,971,159	3,080,987
Total assets		**8,132,279**	7,200,834
EQUITY			
Capital and reserves attributable to the Company's equity holders			
Share capital	13	**1,063,944**	1,063,944
Other reserves	14	**922,720**	883,785
Retained earnings			
— Proposed final dividend		**159,592**	159,592
— Others		**1,769,668**	1,737,392
Total equity		**3,915,924**	3,844,713

	Note	As at 31st December 2005 Rmb'000	2004 Rmb'000
LIABILITIES			
Non-current liabilities			
Borrowings	16	**705,000**	692,045
Trade and other payables	15	**126,144**	—
Deferred income	17	**10,154**	—
		841,298	692,045
Current liabilities			
Trade and other payables	15	**1,468,247**	1,552,631
Current income tax payable		**—**	27,545
Borrowings	16	**1,906,810**	1,083,900
		3,375,057	2,664,076
Total liabilities		**4,216,355**	3,356,121
Total equity and liabilities		**8,132,279**	7,200,834
Net current (liabilities)/assets		**(403,898)**	416,911
Total assets less current liabilities		**4,757,222**	4,536,758

The notes on pages 65 to 112 are an integral part of these financial statements.

INCOME STATEMENT

For the year ended 31st December 2005

	Note	2005 Rmb'000	2004 Rmb'000
Sales	4	**8,856,126**	8,551,923
Cost of goods sold	19	**(8,128,093)**	(7,237,096)
Gross profit		**728,033**	1,314,827
Selling and marketing costs	19	**(150,380)**	(138,936)
Administrative expenses	19	**(176,352)**	(202,833)
Other gains/(losses) - net	18	**6,463**	(9,691)
Operating profit		**407,764**	963,367
Finance costs	21	**(132,120)**	(91,211)
Profit before income tax		**275,644**	872,156
Income tax expense	22	**(44,841)**	(28,433)
Profit for the year		**230,803**	843,723
Attributable to:			
Equity holders of the Company		**230,803**	843,723
Earnings per share for profit attributable to the equity holders of the Company during the year			
— Basic and diluted	23	**Rmb0.217**	Rmb0.793
Dividends	24	**159,592**	159,592

The notes on pages 65 to 112 are an integral part of these financial statements.

Statement of Changes in Equity

For the year ended 31st December 2005

	Note	Share capital Rmb'000	Other reserves Rmb'000 (Note 14)	Retained earnings Rmb'000	Total Rmb'000
		Attributable to the equity holders of the Company			
Balance at 1st January 2004		1,063,944	755,082	1,394,753	3,213,779
Profit for the year		—	—	843,723	843,723
Dividend relating to 2003	24	—	—	(212,789)	(212,789)
Transfer to reserves		—	128,703	(128,703)	—
Balance at 31st December 2004		1,063,944	883,785	1,896,984	3,844,713
Balance at 1st January 2005		1,063,944	883,785	1,896,984	3,844,713
Profit for the year		—	—	230,803	230,803
Dividend relating to 2004	24	—	—	(159,592)	(159,592)
Transfer to reserves		—	38,935	(38,935)	—
Balance at 31st December 2005		1,063,944	922,720	1,929,260	3,915,924

The notes on pages 65 to 112 are an integral part of these financial statements.

Cash Flow Statement

For the year ended 31st December 2005

	Note	2005 Rmb'000	2004 Rmb'000
CASH FLOWS FROM OPERATING ACTIVITIES			
Cash generated from operations	25	**298,599**	540,030
Interest paid		**(129,544)**	(90,727)
Income tax paid		**(73,304)**	(2,076)
Net cash generated from operating activities		**95,751**	447,227
CASH FLOWS FROM INVESTING ACTIVITIES			
Purchase of property, plant and equipment		**(1,254,098)**	(984,873)
Proceeds from disposals of property, plant and equipment	25(a)	**20,394**	10,251
Purchase of land use right		**—**	(27,666)
Decrease/(increase) of bank deposits with maturity over 3 months		**165,530**	(165,530)
Interest received		**9,385**	8,450
Net cash used in investing activities		**(1,058,789)**	(1,159,368)
CASH FLOWS FROM FINANCING ACTIVITIES			
Proceeds from borrowings		**2,064,900**	932,195
Repayments of borrowings		**(1,225,748)**	(619,150)
Dividends paid		**(159,592)**	(212,789)
Net cash generated from financing activities		**679,560**	100,256
Net decrease in cash and cash equivalents		**(283,478)**	(611,885)
Cash and cash equivalents at beginning of the year		**734,698**	1,346,583
Cash and cash equivalents at end of the year	12	**451,220**	734,698

The notes on pages 65 to 112 are an integral part of these financial statements.

1 GENERAL INFORMATION

Chongqing Iron and Steel Company Limited (the "Company") is a joint stock limited liability company established in the People's Republic of China (the "PRC") in August 1997 as part of the restructuring ("Restructuring") of a state-owned enterprise known as Chongqing Iron and Steel Company (Group) Limited (the "Holding Company"). Pursuant to the Restructuring, the principal iron and steel business undertakings and one of the subsidiaries of the Holding Company, Chongqing Hengda Steel Industrial Co., Ltd. ("Hengda"), were taken over by the Company, whereupon the Company issued 650,000,000 state-owned shares of Rmb1 each to the Holding Company. The Company has its primary listing on The Stock Exchange of Hong Kong Limited since 17th October 1997.

In December 2002, the Company acquired all assets and liabilities of Hengda, the former subsidiary of the Company. At the same time, the Company disposed of its entire interest in Hengda to its Holding Company. Following the disposal of Hengda, the Company does not have any subsidiary.

The Company is principally engaged in the manufacture and sale of steel products.

The address of the Company's registered office is No.30, Gangtie Road, Dadukou District, Chongqing, the PRC.

These financial statements have been approved for issue by the board of directors on 30th March 2006.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The principal accounting policies applied in the preparation of these financial statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

(a) Basis of preparation

The financial statements of the Company have been prepared in accordance with Hong Kong Financial Reporting Standards ("HKFRS"). The financial statements have been prepared under the historical cost convention, as modified by financial assets and financial liabilities at fair value through profit or loss.

The preparation of financial statements in conformity with HKFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Company's accounting policies.

Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Although the Company makes estimates and assumptions based on management's best knowledge concerning the future, the resulting accounting estimates will, by definition, seldom equal the related actual results. During the year, the Company has no estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

(a) Basis of preparation *(continued)*

The adoption of new / revised HKFRS

In 2005, the Company adopted the new / revised standards and interpretations of HKFRS below, which are relevant to its operations. The 2004 comparatives have been amended as required, in accordance with the relevant requirements.

HKAS 1	Presentation of Financial Statements
HKAS 2	Inventories
HKAS 7	Cash Flow Statements
HKAS 8	Accounting Policies, Changes in Accounting Estimates and Errors
HKAS 10	Events after the Balance Sheet Date
HKAS 16	Property, Plant and Equipment
HKAS 17	Leases
HKAS 21	The Effects of Changes in Foreign Exchange Rates
HKAS 23	Borrowing Costs
HKAS 24	Related Party Disclosures
HKAS 32	Financial Instruments: Disclosures and Presentation
HKAS 33	Earnings per Share
HKAS 36	Impairment of Assets
HKAS 38	Intangible Assets
HKAS 39	Financial Instruments: Recognition and Measurement
HKAS 39 Amendment	Financial Instruments: Transition and Initial Recognition of Financial Assets and Financial Liabilities
HKAS-Int 15	Operating Leases - Incentives
HKAS-Int 21	Income Taxes - Recovery of Revalued Non-Depreciable Assets

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

(a) Basis of preparation *(continued)*

The adoption of new / revised HKASs 1, 2, 7, 8, 10, 16, 21, 23, 24, 33, 36 and 38 and HKAS-Ints, 15 and 21 did not result in substantial changes to the Company's accounting policies. In summary:

— HKAS 1 has affected the presentation of certain disclosures.

— HKASs 2, 7, 8, 10, 16, 23, 33, 36 and 38 and HKAS-Ints 15 and 21 had no material effect on the Company's policies.

— HKAS 21 had no material effect on the Company's policy. The functional currency of the Company has been re-evaluated based on the guidance to the revised standard. There is no change in the Company's functional currency after the re-evaluation. The Company has the same functional currency as the presentation currency for the financial statements.

— HKAS 24 has affected the identification of related parties and some other related-party disclosures.

The adoption of revised HKAS 17 has resulted in a change in the accounting policy relating to the reclassification of land use right from property, plant and equipment to operating leases. The up-front prepayment made for the land use right is expensed in the income statement on a straight-line basis over the period of the lease or when there is impairment, the impairment is expensed in the income statement (Note 2(f) below). In prior years, the land use right was accounted for at cost less accumulated depreciation and accumulated impairment.

The adoption of HKASs 32 and 39 has resulted in a change in the accounting policy relating to the classification of available-for-sale financial assets. It has also resulted in the recognition of financial instruments at fair value.

All changes in the accounting policies have been made in accordance with the transition provisions in the respective standards, wherever applicable. All standards adopted by the Company require retrospective application.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

(a) Basis of preparation *(continued)*

Certain new standards, amendments and interpretations to existing standards have been published that are mandatory for the Company's accounting periods beginning on or after 1st January 2006 or later periods but which the Company has not early adopted, as follows:

— HKAS 19 (Amendment), Employee Benefits (effective from 1st January 2006).

— HKAS 39 (Amendment), Cash Flow Hedge Accounting of Forecast Intragroup Transactions (effective from 1st January 2006).

— HKAS 39 (Amendment), The Fair Value Option (effective from 1st January 2006).

— HKAS 39 and HKFRS 4 (Amendment), Financial Guarantee Contracts (effective from 1st January 2006).

— HKFRS 1 (Amendment), First-time Adoption of Hong Kong Financial Reporting Standards and HKFRS 6 (Amendment), Exploration for and Evaluation of Mineral Resources (effective from 1st January 2006).

— HKFRS 6, Exploration for and Evaluation of Mineral Resources (effective from 1st January 2006).

— HKFRS 7, Financial Instruments: Disclosures, and a complementary Amendment to HKAS 1, Presentation of Financial Statements - Capital Disclosures (effective from 1st January 2007).

— HKFRS-Int 4, Determining whether an Arrangement contains a Lease (effective from 1st January 2006).

— HKFRS-Int 5, Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds (effective from 1st January 2006).

— HK(IFRIC)-Int 6, Liabilities arising from Participating in a Specific Market - Waste Electrical and Electronic Equipment (effective from 1st December 2005).

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

(a) Basis of preparation *(continued)*

The Company is assessing the impact of the above standards, amendments and interpretations.

This basis of accounting differs from that used in the statutory accounts of the Company which are prepared in accordance with the accounting principles and the relevant financial regulations applicable to enterprises in the PRC (the "PRC GAAP").

(b) Segment reporting

A business segment is a group of assets and operations engaged in providing products or services that are subject to risks and returns that are different from those of other business segments. A geographical segment is engaged in providing products or services within a particular economic environment that are subject to risks and returns that are different from those of segments operating in other economic environments.

(c) Foreign currency translation

(i) Functional and presentation currency

Items included in the financial statements of the Company are measured using the currency of the primary economic environment in which the Company operates (the "functional currency"). The financial statements are presented in Renminbi ("Rmb"), which is the Company's functional and presentation currency.

(ii) Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

(d) Property, plant and equipment

Property, plant and equipment are stated at historical cost less depreciation and impairment losses. Historical cost includes expenditure that is directly attributable to the acquisition of the items.

Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Company and the cost of the item can be measured reliably. All other repairs and maintenance are expensed in the income statement during the financial period in which they are incurred.

Depreciation of property, plant and equipment is calculated using the straight-line method to allocate their costs to their residual values over their estimated useful lives, as follows:

— Buildings	40-45 years
— Plant and machinery	8-22 years
— Transportation vehicles and equipment	8 years

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date.

An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount (Note 2(f)).

Construction in progress represents plant and property under construction and machinery under testing and installation and is stated at cost. This includes costs of construction, plant and equipment and other direct costs. Construction in progress is not depreciated until such time as the relevant assets are completed and are capable of operating in the manner intended by management.

Gains and losses on disposals are determined by comparing proceeds with carrying amount. These are included in the income statement.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

(e) Land use right

Land use right acquired is classified as operating leases. The up-front prepayment made for the land use right is expensed in the income statement on a straight-line basis over the period of the land use right (50 years).

(f) Impairment of non-financial assets

Assets that have an indefinite useful life are not subject to amortisation, which are at least tested annually for impairment and are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units). Non-financial assets other than goodwill that suffered an impairment are reviewed for possible reversal of the impairment at each reporting date.

(g) Financial assets

The Company classifies its financial assets in the following categories: loans and receivables and available-for-sale financial assets. The classification depends on the purpose for which the financial assets were acquired. Management determines the classification of its financial assets at initial recognition and re-evaluates this designation at every reporting date.

(i) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are included in current assets, except for maturities greater than 12 months after the balance sheet date. These are classified as non-current assets. Loans and receivables are classified as trade and other receivables in the balance sheet (Note 2(i)).

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

(g) Financial assets *(continued)*

(ii) Available-for-sale financial assets

Available-for-sale financial assets are non-derivatives that are either designated in this category or not classified in any of the other categories. They are included in non-current assets unless management intends to dispose of the investment within 12 months of the balance sheet date.

Regular purchases and sales of financial assets are recognised on trade-date - the date on which the Company commits to purchase or sell the asset. Financial assets are initially recognised at fair value plus transaction costs for all financial assets not carried at fair value through profit or loss. Financial assets are derecognised when the rights to receive cash flows from the financial assets have expired or have been transferred and the Company has transferred substantially all risks and rewards of ownership. Available-for-sale financial assets are subsequently carried at fair value. Loans and receivables are carried at amortised cost using the effective interest method.

Changes in the fair value of monetary securities denominated in a foreign currency and classified as available-for-sale are analysed between translation differences resulting from changes in amortised cost of the security and other changes in the carrying amount of the security. The translation differences are recognised in profit or loss, and other changes in carrying amount are recognised in equity. Changes in the fair value of monetary securities classified as available-for-sale and non-monetary securities classified as available-for-sale are recognised in equity.

When securities classified as available-for-sale are sold or impaired, the accumulated fair value adjustments recognised in equity are included in the income statement as gains or losses from investment securities. Interest on available-for-sale securities calculated using the effective interest method is recognised in the income statement. Dividends on available-for-sale equity instruments are recognised in the income statement when the Company's right to receive payments is established.

Investment in equity instrument that does not have a quoted market price in an active market and whose fair value cannot be reliably measured, is measured at cost.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

(g) Financial assets *(continued)*

The Company assesses at each balance sheet date whether there is objective evidence that a financial asset or a group of financial assets is impaired. In the case of equity securities classified as available-for-sale, a significant or prolonged decline in the fair value of the security below its cost is considered an indicator that the securities are impaired. If any such evidence exists for available-for-sale financial assets, the cumulative loss (measured as the difference between the acquisition cost and the current fair value), less any impairment loss on that financial asset previously recognised in profit or loss, is removed from equity and recognised in the income statement. Impairment losses recognised in the income statement on equity instruments are not reversed through the income statement. Impairment testing of trade receivables is described in Note 2(i).

(h) Inventories

Inventories are stated at the lower of cost and net realisable value. Cost is determined using the weighted average method. The cost of finished goods and work in progress comprises design costs, raw materials, direct labour, other direct costs and related production overheads (based on normal operating capacity). It excludes borrowing costs. Net realisable value is the estimated selling price in the ordinary course of business, less applicable variable selling expenses.

(i) Trade and other receivables

Trade and other receivables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method, less provision for impairment. A provision for impairment of trade and other receivables is established when there is objective evidence that the Company will not be able to collect all amounts due according to the original terms of receivables. Significant financial difficulties of the debtor, probability that the debtor will enter bankruptcy or financial reorganisation, and default or delinquency in payments are considered indicators that the trade receivable is impaired. The amount of the provision is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the effective interest rate. The amount of the provision is recognised in the income statement.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

(j) Cash and cash equivalents

Cash and cash equivalents include cash in hand, deposits held at call with banks, other short-term highly liquid investments with original maturities of 3 months or less and bank overdrafts. Bank overdrafts are shown within borrowings in current liabilities on the balance sheet.

(k) Share capital

Ordinary shares are classified as equity.

Incremental costs directly attributable to the issue of new shares or options are shown in equity as a deduction, net of tax, from the proceeds.

(l) Borrowings

Borrowings are recognised initially at fair value, net of transaction costs incurred. Transaction costs are incremental costs that are directly attributable to the acquisition, issue or disposal of a financial asset or financial liability, including fees and commissions paid to agents, advisers, brokers and dealers, levies by regulatory agencies and securities exchanges, and transfer taxes and duties. Borrowings are subsequently stated at amortised cost; any difference between the proceeds (net of transaction costs) and the redemption value is recognised in the income statement over the period of the borrowings using the effective interest method.

Borrowing costs incurred are expensed in the income statement.

Borrowings are classified as current liabilities unless the Company has an unconditional right to defer settlement of the liability for at least 12 months after the balance sheet date.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

(m) Deferred income tax

Deferred income tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. However, the deferred income tax is not accounted for if it arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss. Deferred income tax is determined using tax rates (and laws) that have been enacted or substantially enacted by the balance sheet date and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled.

Deferred income tax assets are recognised to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised.

(n) Pension obligations

The Company's employees participate in defined contribution retirement schemes organised by the municipal government and the Holding Company whereby the Company is required to make monthly contributions to the plans at certain percentages of the employees' salaries. The municipal government and the Holding Company have respectively undertaken to assume the retirement benefit obligation of all existing and future retired employees' payable under the relevant plans. The Company has no obligation for the payment of retirement and other post-retirement benefits of employees other than the monthly contributions described above. Contributions to the retirement benefit schemes are recognised as employee benefit expense and charged to the income statement as incurred.

(o) Provisions

Provisions for environmental restoration, restructuring costs and legal claims are recognised when: the Company has a present legal or constructive obligation as a result of past events; it is more likely than not that an outflow of resources will be required to settle the obligation; and the amount has been reliably estimated. Restructuring provisions comprise lease termination penalties and employee termination payments. Provisions are not recognised for future operating losses.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

(o) Provisions *(continued)*

Where there are a number of similar obligations, the likelihood that an outflow will be required in settlement is determined by considering the class of obligations as a whole. A provision is recognised even if the likelihood of an outflow with respect to any one item included in the same class of obligations may be small.

Provisions are measured at the present value of the expenditures expected to be required to settle the obligation using a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the obligation. The increase in the provision due to passage of time is recognised as interest expense.

(p) Revenue recognition

Revenue comprises the fair value of the consideration received or receivable for the sale of goods and services in the ordinary course of the Company's activities. Revenue is shown, net of value-added tax, returns, rebates and discounts and after eliminating sales within the Company. Revenue is recognised as follows:

(i) Sales of goods

Sales of goods are recognised when the Company has delivered products to the customer, the customer has accepted the products and collectibility of the related receivables is reasonably assured.

(ii) Sales of services

Provision of transportation and other services are recognised in the accounting period in which the services are rendered.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

(p) Revenue recognition *(continued)*

(iii) Interest income

Interest income is recognised on a time-proportion basis using the effective interest method. When a receivable is impaired, the Company reduces the carrying amount to its recoverable amount, being the estimated future cash flow discounted at original effective interest rate of the instrument, and continues unwinding the discount as interest income. Interest income on impaired loans is recognised using the original effective interest rate.

(iv) Operating lease (as the lessor)

Operating lease rental income (as the lessor) is recognised on a straight-line basis over the period of the lease.

(q) Operating lease (as the lessee)

Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases (net of any incentives received from the lessor) are charged in the income statement on a straight-line basis over the period of the lease.

(r) Government grants

Grants from the government are recognised at their fair value where there is a reasonable assurance that the grant will be received and the Company will comply with all attached conditions.

Government grants relating to costs are deferred and recognised in the income statement over the period necessary to match them with the costs that they are intended to compensate.

Government grants relating to the purchase of property, plant and equipment are included in non-current liabilities as deferred government grants and are recognised in the income statement on a straight line basis over the expected lives of the related assets.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

(s) Dividend distribution

Dividend distribution to the Company's shareholders is recognised as a liability in the Company's financial statements in the period in which the dividends are approved by the Company's shareholders.

(t) Comparatives

The comparative figures presented in these financial statements are prepared by the Company and have been adjusted for the impact of the relevant new HKFRSs as set out in Note 2(a) to these financial statements.

3 FINANCIAL RISK MANAGEMENT

(a) Financial risk factors

The Company's activities expose it to a variety of financial risks: market risk (including currency risk, fair value interest rate risk and price risk), credit risk, liquidity risk and cash flow interest-rate risk. The Company's overall risk management programme focuses on the unpredictability of financial markets and seeks to minimise potential adverse effects on the Company's financial performance. Risk management is carried out by the Finance Department under policies approved by the Board of Directors.

(i) Market risk

(1) Foreign exchange risk

The Company has assets and liabilities that are subject to fluctuations in foreign currency exchange rates. However, the Company does not use any derivative instruments to reduce its economic exposure to changes in exchange rates. As at 31st December 2005, the Company had the following foreign currency denominated assets and liabilities:

3 FINANCIAL RISK MANAGEMENT *(continued)*

(a) Financial risk factors *(continued)*

(i) Market risk *(continued)*

(1) Foreign exchange risk *(continued)*

	2005 Rmb'000	2004 Rmb'000
Cash at bank		
— US Dollar ("USD") denominated	**10,556**	218,732
— HK Dollar ("HKD") denominated	**42**	42
	10,598	218,774
Bank borrowings		
— USD denominated	**242,160**	248,295

(2) Price risk

As the Company sells steel products at market prices, it is exposed to fluctuations in these prices.

(ii) Credit risk

The Company has no significant concentrations of credit risk. It has policies in place to ensure that sales of products are made to customers with an appropriate credit history. It also has policies that limit the amount of credit exposure to any financial institution.

(iii) Liquidity risk

Prudent liquidity risk management implies maintaining sufficient cash and the availability of funding through an adequate amount of committed credit facilities.

3 FINANCIAL RISK MANAGEMENT *(continued)*

(a) Financial risk factors *(continued)*

(iv) Cash flow and fair value interest rate risk

As the Company has no significant interest-bearing assets, the Company's income and operating cash flows are substantially independent of changes in market interest rates, except for the trade and other payables as described in Note 15.

The Company's interest-rate risk arises from long-term borrowings. Borrowings issued at variable rates expose the Company to cash flow interest-rate risk. Borrowings issued at fixed rates expose the Company to fair value interest-rate risk. The Company policy is to maintain most of its borrowings in fixed rate instruments. At the year end, 91% of borrowings were at fixed rates.

(b) Fair value estimation

The fair value of financial instruments that are not traded in an active market (for example, loans and receivables) is determined by using valuation techniques. The Company uses a variety of methods and makes assumptions that are based on market conditions existing at each balance sheet date. Valuation techniques, such as estimated discounted cash flows, are used to determine fair value for the financial instruments.

The nominal value less impairment provision of trade receivables and payables are assumed to approximate their fair values. The fair value of financial liabilities for disclosure purposes is estimated by discounting the future contractual cash flows at the current market interest rate that is available to the Company for similar financial instruments. Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

4 SEGMENT INFORMATION

The Company mainly conducts its business within one business segment - the business of manufacture and sale of steel products in the PRC. No segment statement of income has been prepared by the Company for the year ended 31st December 2005. The Company also mainly operates within one geographical segment because its revenue is primarily generated in the PRC and its assets are located in the PRC. Accordingly, no geographical segment data is presented.

5 PROPERTY, PLANT AND EQUIPMENT

	Buildings	Plant and machinery	Transportation vehicles and equipment	Construction in progress	Total
	Rmb'000	*Rmb'000*	*Rmb'000*	*Rmb'000*	*Rmb'000*
At 1st January 2004					
Cost	1,707,333	3,535,149	34,615	358,097	5,635,194
Accumulated depreciation and impairment	(709,593)	(1,625,167)	(21,098)	(1,604)	(2,357,462)
Net book amount	997,740	1,909,982	13,517	356,493	3,277,732
Year ended 31st December 2004					
Opening net book amount	997,740	1,909,982	13,517	356,493	3,277,732
Additions	2,960	4,141	1,680	994,916	1,003,697
Transfers	21,535	121,161	—	(142,696)	—
Disposals (Note 25)	(6,014)	(24,142)	(6,313)	—	(36,469)
Depreciation charge	(43,879)	(160,304)	(2,144)	—	(206,327)
Closing net book amount	972,342	1,850,838	6,740	1,208,713	4,038,633
At 31st December 2004					
Cost	1,720,000	3,475,008	23,007	1,209,390	6,427,405
Accumulated depreciation and impairment	(747,658)	(1,624,170)	(16,267)	(677)	(2,388,772)
Net book amount	972,342	1,850,838	6,740	1,208,713	4,038,633

5 PROPERTY, PLANT AND EQUIPMENT (continued)

	Buildings	Plant and machinery	Transportation vehicles and equipment	Construction in progress	Total
	Rmb'000	Rmb'000	Rmb'000	Rmb'000	Rmb'000
Year ended 31st December 2005					
Opening net book amount	972,342	1,850,838	6,740	1,208,713	4,038,633
Additions	4,156	16,139	—	1,240,792	1,261,087
Transfers	228,297	759,684	746	(988,727)	—
Disposals (Note 25)	(5,813)	(22,932)	(151)	(337)	(29,233)
Depreciation charge	(42,564)	(171,595)	(1,591)	—	(215,750)
Closing net book amount	1,156,418	2,432,134	5,744	1,460,441	5,054,737
At 31st December 2005					
Cost	1,932,374	4,160,322	21,535	1,460,441	7,574,672
Accumulated depreciation and impairment	(775,956)	(1,728,188)	(15,791)	—	(2,519,935)
Net book amount	1,156,418	2,432,134	5,744	1,460,441	5,054,737

As at 31st December 2005, property, plant and equipment with an aggregate carrying amount of Rmb558,102,000 (2004: Rmb346,384,000) was pledged as security for the Company's borrowings (Note 16(a)).

As at 31st December 2005, the Company was in the process of obtaining ownership certificates of certain buildings with carrying amount of Rmb123,449,000 (2004: Rmb16,987,000).

As at 31th December 2005, property, plant and equipment with carrying amount of Rmb14,189,000 (2004: Rmb13,186,000) was fully depreciated and still in use.

Depreciation expense of Rmb211,432,000 (2004: Rmb200,397,000) has been charged in cost of goods sold, Rmb1,141,000 (2004: Rmb1,298,000) in selling and marketing costs and Rmb3,177,000 (2004: Rmb4,632,000) in administrative expenses (Note 19).

6 LAND USE RIGHT

The Company's interest in land use right represents prepaid operating lease payment for a parcel of land in the PRC with a lease period of 50 years. The net book amount of land use right is analysed as follows:

	2005 *Rmb'000*	2004 *Rmb'000*
Opening net book amount	**27,666**	—
Addition	**—**	27,666
Amortisation (Note 19)	**(376)**	—
Closing net book amount	**27,290**	27,666

As at 31st December 2005, land use right with carrying amount of Rmb27,290,000 (2004: Nil) was pledged as security for the Company's borrowings (Note 16(a)).

7 AVAILABLE-FOR-SALE FINANCIAL ASSET

	2005 *Rmb'000*	2004 *Rmb'000*
Unlisted shares, at cost	**5,000**	5,000

Non-current available-for-sale financial asset represents a 2% shareholding in Xiamen Shipbuilding Industry Co., Ltd. This investment is stated at cost because there is no quoted market price available in an active market, nor any other alternative method available that can reasonably estimate the fair value of the investment.

There were no disposal or impairment provisions on available-for-sale financial asset in 2005.

8 DEFERRED INCOME TAX ASSETS

Deferred income tax assets were calculated in full on temporary differences under the liability method using a principal tax rate of 15% (2004: 15%).

Deferred income tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets against current income tax liabilities and when the deferred income taxes related to the same fiscal authority. The amounts of deferred income tax assets are as follows:

	2005	2004
	Rmb'000	*Rmb'000*
Deferred income tax assets:		
— Deferred income tax assets to be recovered after more than 12 months	**2,493**	2,493
— Deferred income tax assets to be recovered within 12 months	**—**	7,282
	2,493	9,775

The movement on the deferred income tax assets is as follows:

	2005	2004
	Rmb'000	*Rmb'000*
Beginning of the year	**9,775**	10,757
Charged to the income statement (Note 22)	**(7,282)**	(982)
End of the year	**2,493**	9,775

8 DEFERRED INCOME TAX ASSETS *(continued)*

The components of deferred income tax assets during the year are as follows:

	Beginning of the year *Rmb'000*	(Charged)/ credited to the income statement *Rmb'000*	End of the year *Rmb'000*
Deferred income tax assets:			
Year ended 31st December 2004			
— Provisions for impairments of receivables and inventories	1,046	499	1,545
— Provision for impairment of property, plant and equipment	4,111	(2,594)	1,517
— Loss on disposals of property, plant and equipment	3,785	1,098	4,883
— Loss on write off of inventories	1,815	15	1,830
	10,757	(982)	9,775
Year ended 31st December 2005			
— Provisions for impairments of receivables and inventories	1,545	(569)	976
— Provision for impairment of property, plant and equipment	1,517	—	1,517
— Loss on disposals of property, plant and equipment	4,883	(4,883)	—
— Loss on write-off of inventories	1,830	(1,830)	—
	9,775	(7,282)	2,493

8 DEFERRED INCOME TAX ASSETS *(continued)*

The above deferred income tax assets arise in the following circumstances:

— Provisions for impairments of receivables, inventories and property, plant and equipment are not tax deductible until approved by the local tax authority;

— Loss on disposals of property, plant and equipment is not tax deductible until approved by the local tax authority;

— Loss on write-off of inventories is not tax deductible until approved by the local tax authority.

9 INVENTORIES

	2005	2004
	Rmb'000	*Rmb'000*
Raw materials	**1,163,846**	975,823
Work in progress	**270,768**	207,253
Finished goods	**222,059**	236,777
Spare parts and consumables	**192,668**	121,414
	1,849,341	1,541,267

As at 31st December 2005, the carrying amount of finished goods that were carried at net realisable value amounted to Rmb187,039,000 (2004: Nil).

During the year ended 31st December 2005, the Company reversed a provision for impairment of inventories of Rmb3,881,000 (2004: write-down of Rmb10,000,000) made in prior years. The amount reversed has been included in cost of goods sold in the income statement (Note 19).

The cost of inventory recognised as expenses and included in cost of goods sold amounted to Rmb6,347,620,000 (2004: Rmb5,243,847,000).

10 TRADE AND OTHER RECEIVABLES

	2005 Rmb'000	2004 Rmb'000
Notes receivables	**387,540**	253,937
Accounts receivable (Note (a))	**249,337**	271,860
Trade receivables	**636,877**	525,797
Less: provision for impairment of trade receivables	**(153,702)**	(157,832)
Trade receivables - net	**483,175**	367,965
Receivables from fellow subsidiaries of the Holding Company (Note (b) and 28(d))	**68,028**	63,479
Less: provision for impairment of receivables from fellow subsidiaries of the Holding Company	**(2,710)**	(2,710)
Receivables from fellow subsidiaries of the Holding Company - net	**65,318**	60,769
Prepayments and deposits	**145,204**	141,442
Other receivables	**25,440**	52,616
Less: provision for impairment of other receivables (Note (c))	**(10,659)**	(6,131)
Other receivables - net	**14,781**	46,485
	708,478	616,661
Less non-current portion: prepayment to a supplier	**(71,600)**	(38,773)
Current portion	**636,878**	577,888

10 TRADE AND OTHER RECEIVABLES *(continued)*

The fair values of trade and other receivables are as follows:

	2005	2004
	Rmb'000	*Rmb'000*
Trade receivables	**483,175**	367,965
Receivables from fellow subsidiaries of the Holding Company	**65,318**	60,769
Prepayments and deposits	**145,204**	141,442
Other receivables	**14,781**	46,485
	708,478	616,661

The maturity of non-current prepayment to a supplier is as follows:

	2005	2004
	Rmb'000	*Rmb'000*
Between 1 and 2 years	**9,000**	8,400
Between 2 and 5 years	**41,400**	30,373
Over 5 years	**21,200**	—
	71,600	38,773

10 TRADE AND OTHER RECEIVABLES *(continued)*

(a) The Company normally requires advanced payments from new customers before delivery. For existing customers, the Company normally offers a 1-month credit period. The ageing analysis of accounts receivables as at 31st December 2005 is as follows:

	2005	2004
	Rmb'000	*Rmb'000*
Within 3 months	**89,614**	106,015
Between 3 months and 1 year	**3,498**	6,050
Between 1 and 2 years	**2,092**	2,864
Between 2 and 3 years	**2,257**	234
Over 3 years	**151,876**	156,697
	249,337	271,860

There is no concentration of credit risk with respect to trade receivables, as the Company has a large number of customers, domestically dispersed.

During the year ended 31st December 2005, the Company reversed the provision for impairment of trade and other receivables of Rmb2,705,000 (2004: Reversal of Rmb8,600,000) made in prior years. The amount reversed has been included in administrative expenses in the income statement (Note 19).

During the year ended 31st December 2005, accounts receivable of Rmb1,425,000 (2004: Rmb2,998,000) was written off, of which impairment provision had been fully provided in prior years.

10 TRADE AND OTHER RECEIVABLES *(continued)*

(b) The ageing analysis of receivables from fellow subsidiaries of the Holding Company as at 31st December 2005 is as follows:

	2005	2004
	Rmb'000	*Rmb'000*
Within 3 months	**18,709**	33,645
Between 3 months and 1 year	**33,627**	15,474
Between 1 and 2 years	**3,650**	11,650
Between 2 and 3 years	**9,332**	–
Over 3 years	**2,710**	2,710
	68,028	63,479

(c) During the year ended 31st December 2005, the Company had received verdicts and enforcement orders from certain courts ("the Courts"), including the People's Courts of Neijiang, Sichuan Province of the PRC, in relation to certain debts owed by the Holding Company and Chongqing Special Steel (Group) Limited Company ("CSSG"; former subsidiary of the Parent Company who ceased to have shareholding relationship with the Holding Company since June 2003) to their creditors amounting to Rmb18,200,000 and Rmb18,340,000, respectively. According to these verdicts and enforcement orders, the Company was requested to withhold in aggregate Rmb36,540,000 dividend to be distributed to the Holding Company ("the Dividend"). The Company did not withhold the Dividend and without notifying the Company, one of the Courts had withdrawn Rmb4,528,000 from the Company's bank accounts.

Based on the advice from the Company's legal counsellor, management of the Company is of the view that the verdicts and the enforcement orders made by the Courts are without merit as CSSG is no longer associated with the Holding Company or the Company, and accordingly the Company has no obligation to assist the execution of the verdicts. The Company has made objections to the Courts and seek assistance and resolution from relevant higher courts, Municipal Governments and Standing Committee of the People's Congress. As at 31st December 2005 and the date of these financial statements, the abovementioned objection application and the cases have not been finalised. As the recoverability of this withdrawn bank deposits (recorded as other receivable) is uncertain, management of the Company recorded an impairment provision of Rmb4,528,000 as other gains/losses for the year ended 31st December 2005 (Note 18).

11 BANK DEPOSITS WITH MATURITY OVER 3 MONTHS AND RESTRICTED CASH

	2005 Rmb'000	2004 Rmb'000
Restricted cash deposits for letter of credit	**13,342**	61,604
Bank deposits with maturity over 3 months	**—**	165,530
	13,342	227,134

The effective interest rate on bank deposits with maturity over 3 months is 2.7% (2004: 2.7%).

Bank deposits with maturity over 3 months and restricted cash of Rmb85,000 (2004: Rmb44,483,000) are deposited in state-owned banks (Note 28(d)).

12 CASH AND CASH EQUIVALENTS

	2005 Rmb'000	2004 Rmb'000
Cash in hand	**799**	374
Cash and short-term bank deposits	**450,421**	734,324
	451,220	734,698

Short-term bank deposits of Rmb389,453,000 (2004: Rmb626,955,000) are deposited in state-owned banks (Note 28(d)).

13 SHARE CAPITAL

	2005 Number of Shares ('000)	2004 Number of Shares ('000)	2005 Rmb'000	2004 Rmb'000
Registered, issued and fully paid:				
State-owned shares of Rmb1 each	**650,000**	650,000	**650,000**	650,000
H shares of Rmb1 each	**413,944**	413,944	**413,944**	413,944
	1,063,944	1,063,944	**1,063,944**	1,063,944

The state-owned shares and H shares rank pari passu in all respects.

14 OTHER RESERVES

	Share premium Rmb'000	Capital surplus Rmb'000 Note (a)	Statutory common reserve Rmb'000 Note (b)	Statutory provident fund Rmb'000 Note (c)	Total Rmb'000
At 1st January 2004	276,208	216,071	175,202	87,601	755,082
Transfer from retained earnings	—	—	85,802	42,901	128,703
At 31st December 2004	276,208	216,071	261,004	130,502	883,785
At 1st January 2005	276,208	216,071	261,004	130,502	883,785
Transfer from retained earnings	—	—	25,957	12,978	38,935
At 31st December 2005	276,208	216,071	286,961	143,480	922,720

(a) According to the Company's Articles of Association, the Company shall record the following as capital surplus: (i) donations; (ii) appreciation arising from revaluation of assets; and (iii) other items in accordance with the articles of association and relevant regulations in the PRC. Capital surplus may be utilised to make up losses or for the issuance of bonus shares.

14 OTHER RESERVES *(continued)*

(b) According to the Company's Articles of Association, the Company is required to transfer 10% of its net profit as stated in the statutory accounts prepared under PRC GAAP to statutory common reserve until the reserve reaches 50% of the registered capital. The transfer to this reserve must be made before the distribution of dividend to shareholders.

The statutory common reserve shall only be used to make up losses, to expand the Company's production operations, or to increase the capital of the Company. Upon approval by a resolution of shareholders' general meeting, the Company may convert its statutory common reserve into share capital and issue bonus shares to existing shareholders in proportion to their existing shareholdings or increase the nominal value of each share. After converting the Company's statutory common reserve into capital, the balance of such reserve must not be less than 25% of the registered capital.

For the year ended 31st December 2005, the board of directors of the Company proposed the transfer of 10% (2004: 10%) of the net profit as reported in the PRC statutory accounts to the statutory common reserve, totalling Rmb25,957,000 (2004: Rmb85,802,000). The resolution is subject to the approval by the shareholders at the Annual General Meeting.

(c) According to the Company's Articles of Association, the Company is required to transfer 5% to 10% of its net profit as stated in the statutory accounts prepared under PRC GAAP to statutory provident fund. The transfer to this fund must be made before the distribution of dividend to shareholders. This fund shall only be used for the collective welfare of employees.

For the year ended 31st December 2005, the board of directors of the Company proposed the transfer of 5% (2004: 5%) of the net profit as reported in the PRC statutory accounts to the statutory provident fund, totalling Rmb12,978,000 (2004: Rmb42,901,000). The resolution is subject to the approval by the shareholders at the Annual General Meeting.

15 TRADE AND OTHER PAYABLES

	2005 Rmb'000	2004 Rmb'000
Trade payables (Note (a))	**899,172**	792,859
Advances from customers	**562,600**	512,430
Amounts due to the Holding Company and its subsidiaries (Note 28(d))	**47,667**	55,445
Value added tax and other tax payables	**16,857**	65,190
Salaries payable	**30,003**	54,403
Deposits from customers	**12,565**	8,728
Other payables	**25,527**	63,576
	1,594,391	1,552,631
Less non-current portion:		
- Advance from a customer (Note(b))	**(117,748)**	—
- Other payables	**(8,396)**	—
	(126,144)	—
	1,468,247	1,552,631

(a) The ageing analysis of trade payables as at 31st December 2005 is as follows:

	2005 Rmb'000	2004 Rmb'000
Within 6 months	**687,168**	495,145
Between 6 months and 1 year	**189,514**	269,577
Between 1 and 2 years	**4,955**	8,632
Between 2 and 3 years	**1,744**	1,247
Over 3 years	**15,791**	18,258
	899,172	792,859

(b) The maturity of non-current advance from a customer is between 1 and 2 years.

The effective interest rate on non-current advance from a customer is 5.18%.

16 BORROWINGS

	2005 Rmb'000	2004 Rmb'000
Non-current		
Secured bank borrowings (Note (a))	**285,000**	138,750
Unsecured bank borrowings (Note (b))	**420,000**	553,295
	705,000	692,045
Current		
Secured bank borrowings (Note (a))	**594,000**	519,000
Unsecured bank borrowings (Note (b))	**1,312,810**	564,900
	1,906,810	1,083,900
Total borrowings	**2,611,810**	1,775,945

(a) Bank borrowings of Rmb625,000,000 (2004: Rmb529,000,000) are secured by the Company's property, plant and equipment with net book amount of Rmb93,782,000 (2004: Rmb97,431,000) as at 31st December 2005 (Note 5) together with certain parcels of land use right owned by the Holding Company (Note 28(a)).

Bank borrowings of Rmb254,000,000 (2004: Rmb128,750,000) are secured by the Company's property, plant and equipment with net book amount of Rmb464,320,000 (2004: Rmb248,953,000) (Note 5) together with a parcel of land use right with net book amount of Rmb27,290,000 (2004: Nil) (Note 6) as at 31st December 2005 owned by the Company.

(b) Unsecured bank borrowings of Rmb1,336,900,000 (2004: Rmb829,900,000) are guaranteed by the Holding Company (Note 28(a)).

Bank borrowings of Rmb2,013,650,000 (2004: Rmb1,227,650,000) are borrowed from state-owned banks (Note 28(d)).

16 BORROWINGS *(continued)*

The maturity of borrowings is as follows:

	2005 Rmb'000	2004 Rmb'000
Within 1 year	**1,906,810**	1,083,900
Between 1 and 2 years	**505,000**	692,045
Between 2 and 5 years	**200,000**	—
	2,611,810	1,775,945

The effective interest rates per annum at the balance sheet date were as follows:

	2005		2004	
	Rmb	USD	Rmb	USD
Bank borrowings	**2.88% to 6.73%**	5.56%	2.88% to 6.73%	3.78%

The carrying amounts and fair values of the non-current borrowings are as follows:

	Carrying amounts		Fair values	
	2005 Rmb'000	2004 Rmb'000	2005 Rmb'000	2004 Rmb'000
Bank borrowings	**705,000**	692,045	**708,332**	694,383

The fair values are based on cash flows discounted using rates based on the borrowings rates of 5.76% to 6.34% (2004: 5.28% to 6.73%).

The carrying amounts of current borrowings approximate their fair value.

16 BORROWINGS *(continued)*

The carrying amounts of the borrowings are denominated in the following currencies:

	2005 **Rmb'000**	2004 Rmb'000
Rmb	**2,369,650**	1,527,650
USD	**242,160**	248,295
	2,611,810	1,775,945

As at 31st December 2005, the Company has the following undrawn borrowing facilities:

	2005 **Rmb'000**	2004 Rmb'000
Fixed rate		
— expiring within one year	**265,000**	280,000
— expiring beyond one year	**4,000**	320,000
	269,000	600,000

The facilities expiring within one year are annual facilities subject to review at various dates during 2006. The other facilities have been arranged to help finance the operation of the Company.

17 DEFERRED INCOME

The movement of deferred income is as follows:

	2005 Rmb'000	2004 Rmb'000
At 1st January 2005	**—**	—
Addition	**12,178**	—
Credited to the income statement	**(2,024)**	—
At 31st December 2005	**10,154**	—

In accordance with Cai Shui Zi [2000] No. 49 "The Notice concerning the Reduction in Corporate Income Tax for Purchase of Domestic Manufactured Equipment 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 equipment could be utilised to reduce the Company's enterprise income tax.

In accordance with the approval (Da Dukou Guo Shui Han [2006] No.3) 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 equipment in 2005 and 2004, the Company is entitled to a tax reduction of Rmb89,114,000, of which Rmb12,178,000 was utilised to offset the Company's income tax liability for 2005. The reduction of the Company's income tax liability for 2005 of Rmb12,178,000 was recorded as deferred income and are to be recognised as income on a straight-line basis over the expected lives of the related assets. The remaining of Rmb76,936,000 can be utilised to offset future enterprise income tax payments for not more than 5 years.

18 OTHER GAINS/(LOSSES) - NET

	2005 Rmb'000	2004 Rmb'000
Profit on sale of by-products, net	**3,253**	805
Operating lease rental income	**1,212**	930
Utility installation service income	**4,414**	2,560
Subsidy income	**—**	6,740
Interest income (Note (a))	**9,385**	8,450
Loss on disposals of property, plant and equipment	**(8,839)**	(26,218)
Provision of impairment for other receivables (Note 10(b))	**(4,528)**	—
Bank charges	**(1,737)**	(8,190)
Others	**3,303**	5,232
	6,463	(9,691)

(a) Interest income of Rmb8,845,000 (2004: Rmb4,125,000) is generated from cash and short-term bank deposits in state-owned banks (Note 28(b)).

19 EXPENSES BY NATURE

Expenses included in cost of goods sold, selling and marketing costs and administrative expenses are analysed as follows:

	2005 *Rmb'000*	2004 *Rmb'000*
Depreciation (Note 5)	**215,750**	206,327
Amortisation (Note 6)	**376**	—
Written-back of provision for impairment of receivables (Note 10)	**(2,705)**	(8,600)
Employee benefit expense (Note 20)	**578,401**	584,352
Changes in inventories of finished goods and work in progress	**(57,594)**	(222,921)
Raw materials and consumables used	**6,409,095**	5,456,768
(Written-back of provision)/provision for impairment of inventories (Note 9)	**(3,881)**	10,000
Operating lease expenses (Note 28(b))	**14,521**	14,521
Auditors' remuneration	**2,680**	2,678

20 EMPLOYEE BENEFIT EXPENSE

	2005 *Rmb'000*	2004 *Rmb'000*
Salaries	**389,622**	409,098
Retirement benefit costs - defined contribution plans	**76,191**	77,087
Other social welfare costs	**112,588**	98,167
	578,401	584,352

20 EMPLOYEE BENEFIT EXPENSE

(a) Directors' and supervisors' emoluments

The remuneration of every director and supervisor for the year ended 31st December 2005 is set out below:

Name of director and supervisor	Fees *Rmb'000*	Basic salaries, housing allowances and other allowances *Rmb'000*	Bonuses *Rmb'000*	Pension *Rmb'000*	Total *Rmb'000*
Director:					
Mr. Tang Min Wei	—	28	145	9	182
Mr. Yang Zhi Wei	—	20	137	9	166
Mr. Yuan Jin Fu	—	20	134	9	163
Mr. Chen Shan	—	21	135	9	165
Mr. Sun Yi Jie	—	20	123	9	152
Mr. Tu De Ling	—	20	123	9	152
Mr. Wang Xiang Fei	—	60	—	—	60
Mr. Wu Zhong Fu	—	30	—	—	30
Mr. Sun Yu	—	30	—	—	30
Supervisor:					
Mr. Zhu Jian Pai	—	20	136	9	165
Mr. Huang You He	—	18	77	9	104
Ms. Yuan Xue Bin	—	16	70	9	95
Ms. Chen Hong	—	15	73	9	97
Ms. Lu Kang Mei	—	17	75	9	101
	—	335	1,228	99	1,662

20 EMPLOYEE BENEFIT EXPENSE *(continued)*

(a) Directors' and supervisors' emoluments *(continued)*

The remuneration of every director and supervisor for the year ended 31st December 2004 is set out below:

Name of director and supervisor	Fees *Rmb'000*	Basic salaries, housing allowances and other allowances *Rmb'000*	Bonuses *Rmb'000*	Pension *Rmb'000*	Total *Rmb'000*
Director:					
Mr. Tang Min Wei	—	25	148	7	180
Mr. Yang Zhi Wei	—	18	130	7	155
Mr. Yuan Jin Fu	—	18	96	7	121
Mr. Chen Shan	—	18	123	7	148
Mr. Sun Yi Jie	—	18	117	7	142
Mr. Tu De Ling	—	16	117	7	140
Mr. Wang Xiang Fei	—	60	—	—	60
Mr. Wu Zhong Fu	—	30	—	—	30
Mr. Sun Yu	—	30	—	—	30
Supervisor:					
Mr. Zhu Jian Pai	—	17	98	7	122
Mr. Huang You He	—	16	63	7	86
Ms. Yuan Xue Bin	—	14	59	7	80
Mr. Wu Zi Sheng (i)	—	5	55	3	63
Ms. Liu Xiu Ying (ii)	—	6	25	3	34
Ms. Chen Hong (iii)	—	7	60	4	71
Ms. Lu Kang Mei (iv)	—	8	58	4	70
	—	306	1,149	77	1,532

20 EMPLOYEE BENEFIT EXPENSE *(continued)*

(a) Directors' and supervisors' emoluments *(continued)*

(i) Resigned on 19th May 2004.

(ii) Resigned on 24th March 2004.

(iii) Appointed on 19th May 2004.

(iv) Appointed on 24th March 2004.

The emoluments fell within the following band:

	Number of directors and supervisors	
	2005	2004
Emoluments band		
Nil-HK$1,000,000	**14**	16

No directors and supervisors waived their emoluments and no emoluments were paid or payable by the Company to any directors and supervisors as inducement to join or as compensation for loss of office in respect of the year ended 31st December 2005 (2004: Nil).

(b) Five highest paid individuals

The five individuals whose emoluments were the highest in the Company for both years were the directors or supervisors and their emoluments are reflected in the analysis presented above.

21 FINANCE COSTS

	2005 Rmb'000	2004 Rmb'000
Interest expense on bank borrowings	**127,944**	91,211
Interest expense on trade and other payables	**7,463**	—
Net foreign exchange transaction gains	**(3,287)**	—
	132,120	91,211

Interest expense of Rmb95,668,000 (2004: Rmb76,400,000) is paid/payable for borrowings from state-owned banks (Note 28(b)).

22 INCOME TAX EXPENSE

	2005 Rmb'000	2004 Rmb'000
Current PRC income tax	**37,559**	27,451
Deferred income tax (Note 8)	**7,282**	982
	44,841	28,433

The taxation on the Company's profit before income tax differs from the theoretical amount that would arise using the taxation rate of the Company as follows:

	2005 Rmb'000	2004 Rmb'000
Profit before taxation	**275,644**	872,156
Calculated at taxation rate of 15% (2004: 7.5%) (Note (a))	**41,347**	65,412
Utilisation of previously unrecognised temporary differences	**(3,064)**	(1,957)
Effect of different tax rates applied for the periods in which the temporary differences are expected to reverse	**4,736**	512
Expenses not deductible for/income not subject to taxation	**1,822**	(35,534)
	44,841	28,433

22 INCOME TAX EXPENSE *(continued)*

(a) As a production enterprise with foreign investment established at the riverside of Yangtse River, the Company was originally entitled to a preferential enterprise income tax rate of 24% in accordance with "The Notice issued by the State Tax Bureau on Taxation Policy Concerning Foreign Invested Enterprises for Further Opening of Frontier, Coastal, Inland and Riverside Cities" (Guo Shui Fa [1992] No. 218). In April 2003, the Company obtained approvals (Yu Guo Shui Han [2003] No. 57 and Da Dukou Guo Shui Han [2003] No. 8) issued by the relevant tax authorities under which the preferential enterprise income tax treatment for enterprises in the western development region is granted to the Company. In accordance with these approvals, the Company is entitled to the preferential income tax policy applicable to enterprises in the western development region and the enterprise income tax rate is reduced to 15% for the period from 2001 to 2010. As approved by the tax authority, the Company is exempted from local income tax in 2005 (2004: Nil).

In addition, in accordance with an approval document issued by the Ministry of Foreign Trade and Economic Co-operation 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 a joint stock limited 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 2005 is the Company's sixth profitable year after the above change in status. As such, the applicable enterprise income tax rate of the Company in 2005 is 15% (2004: 7.5%).

No Hong Kong profits tax has been provided as the Company had no taxable profits in Hong Kong for the year (2004: Nil).

23 EARNINGS PER SHARE

Basic earnings per share is calculated by dividing the profit attributable to the equity holders of the Company of Rmb230,803,000 (2004: Rmb843,723,000) by the weighted average number of ordinary shares in issue during the year of 1,063,944,000 shares (2004: 1,063,944,000 shares).

Diluted earnings per share equals to basic earnings per share as there are no potential dilutive shares outstanding as at 31st December 2005 (2004: Nil).

24 DIVIDENDS

In accordance with the relevant regulations of the PRC and the Company's Articles of Association, the Company declares dividends based on the lower of the retained earnings as reported in the PRC statutory accounts and financial statements prepared in accordance with HKFRS. As the statutory accounts have been prepared in accordance with PRC GAAP, the retained earnings as reported in the statutory accounts will be different from the amount reported in the accompanying financial statements.

The dividends paid during the year ended 31st December 2005 and 2004 were Rmb159,592,000 (Rmb0.15 per share) and Rmb212,789,000 (Rmb0.20 per share) respectively. A dividend in respect of 2005 of Rmb0.15 per share, amounting to a total dividend of Rmb159,592,000 and a bonus share dividend of 3 (2004: Nil) shares per 10 shares, totalling bonus shares of 319,184,000 shares (2004: Nil), is to be proposed to the Annual General Meeting. The financial statements of 2005 do not reflect this dividend payable.

	2005	2004
	Rmb'000	*Rmb'000*
Final, proposed, of Rmb0.15 (2004: Rmb0.15) per share	**159,592**	159,592

25 CASH GENERATED FROM OPERATIONS

	2005 Rmb'000	2004 Rmb'000
Profit for the year	**230,803**	843,723
Adjustments for:		
— Taxation (Note 22)	**44,841**	28,433
— Depreciation and amortisation (Notes 5 and 6)	**216,126**	206,327
— Provision/(written-back of provision) for impairment of receivables (Note 10)	**1,823**	(8,600)
— (Written-back of provision)/provision for impairment of inventories (Note 9)	**(3,881)**	10,000
— Loss on disposals of property, plant and equipment (Note (a))	**8,839**	26,218
— Finance costs (Note 21)	**132,120**	91,211
— Interest income (Note 18)	**(9,385)**	(8,450)
Changes in working capital:		
— Inventories	**(304,194)**	(658,508)
— Trade and other receivables	**(93,641)**	(229,227)
— Restricted cash (Note 11)	**48,262**	(61,604)
— Trade and other payables	**26,886**	300,507
Cash generated from operations	**298,599**	540,030

(a) In the cash flow statement, proceeds from disposals of property, plant and equipment comprise:

	2005 Rmb'000	2004 Rmb'000
Net book amount (Note 5)	**29,233**	36,469
Loss on disposals of property, plant and equipment (Note 18)	**(8,839)**	(26,218)
Proceeds from disposals of property, plant and equipment	**20,394**	10,251

26 CONTIGENT LIABILITIES

As at 31st December 2005, the Company had no material contingent liabilities.

27 COMMITMENTS

(a) Capital commitments for property, plant and equipment

	2005 **Rmb'000**	2004 Rmb'000
Contracted but not provided for	**525,956**	1,050,082
Authorised but not contracted for	**501,973**	325,494
	1,027,929	1,375,576

(b) Operating lease commitments

As at 31st December 2005, the future aggregate minimum lease payments under non-cancellable operating leases in respect of land and buildings are as follows:

	2005 **Rmb'000**	2004 Rmb'000
Not later than 1 year	**14,913**	13,313
Later than 1 year and not later than 5 years	**58,186**	52,780
Later than 5 years	**95,597**	495,837
	168,696	561,930

Included in the above operating lease commitments are commitments in respect of two leases of land for a period of 20 years and 15 years from the Holding Company commencing from August 1997 and December 2002, respectively. As at 31st December 2005, the future aggregate minimum lease payments under such operating leases amounted to Rmb155,095,000 (2004: Rmb518,026,000) and Rmb13,107,000 (2004: Rmb43,776,000), respectively.

28 RELATED PARTY TRANSACTIONS

The Company is controlled by the Holding Company (incorporated in the PRC), which owns 61% of the Company's shares. The directors of the Company considered the Holding Company to be the ultimate parent company.

Given that the PRC government still owns a significant portion of the productive assets in the PRC despite the continuous reform of the government structure, the majority of the Company's business activities had been conducted with enterprises directly or indirectly owned or controlled by the PRC government ("state-owned enterprises"), including the Holding Company, its subsidiaries, associated companies and jointly controlled entities in the ordinary course of business. In accordance with the revised HKAS 24, "Related Party Disclosures" ("HKAS 24"), state-owned enterprises and their subsidiaries, other than entities under the Holding Company, directly or indirectly controlled by the PRC government are also defined as related parties of the Company.

The following transactions were carried out with related parties:

(a) The Company's bank borrowings of Rmb625,000,000 (2004: Rmb529,000,000) as at 31st December 2005 are secured by certain parcels of land use right of the Holding Company together with certain property, plant and equipment of the Company (Note 16(a)).

In addition to the above, as at 31st December 2005 the Company's bank borrowings of Rmb1,336,900,000 (2004: Rmb829,900,000) are guaranteed by the Holding Company (Note 16(b)).

28 RELATED PARTY TRANSACTIONS *(continued)*

(b) Other than the transactions described above, the following is a summary of the significant transactions entered into by the Company on normal commercial terms with the Holding Company, fellow subsidiaries and other state-owned enterprises/banks during the year:

	2005	2004
	Rmb'000	*Rmb'000*
Income		
Sales to fellow subsidiaries of the Holding Company (Note (i))	**905,615**	903,244
Sales to other state-owned enterprises (Note (ix))	**3,080,723**	2,758,597
Fees received for supporting services (Note (ii))	**2,646**	3,298
Fees received for lease rental (Note (iii))	**472**	1,136
Interest income from state-owned banks (Note 18 and Note (ix))	**8,845**	4,125
Expenditure		
Fees paid for supporting services (Note (iv))	**335,181**	173,308
Purchase of raw materials and spare parts (Note (v))	**1,168,343**	938,679
Purchase of property, plant and equipment (Note (vi))	**55,686**	284,251
Rental for land (Note (vii))	**14,521**	14,521
Social welfare expenses paid through the Holding Company to schemes administered by the PRC government (Note (viii))	**43,301**	41,036
Staff welfare expenses and supplementary retirement benefit contribution paid to defined contribution retirement schemes administered by the Holding Company	**32,686**	46,390
Purchase from other state-owned enterprises (Note (ix))	**2,685,577**	1,619,471
Interest paid/payable to state-owned banks (Note 21 and Note (ix))	**95,668**	76,400
Borrowings from state-owned banks (Note (ix))	**1,708,900**	503,900

28 RELATED PARTY TRANSACTIONS *(continued)*

(b) (i) Sales to the fellow subsidiaries were made at prices determined by reference to those charged to other third party customers of the Company or the prices as prescribed by the relevant Chongqing government departments.

(ii) Fees received for supporting services mainly represent fees charged to the fellow subsidiaries for internal railway transportation services at prices determined by reference to a profit mark-up above the cost of providing such services as agreed between the Company and the fellow subsidiaries.

(iii) Fees received for lease rental mainly represents fee charged to the fellow subsidiaries for the lease of the Company's factory premises at price determined by reference to a mark-up for maintenance over and above the cost of depreciation of the factory premises.

(iv) Fees paid for supporting services mainly represent fees charged for environmental, maintenance, technical, installation and transportation services provided by the fellow subsidiaries. These services were charged at prices determined by reference to transactions of a similar nature contracted with other third party customers of the fellow subsidiaries or a profit mark-up above the cost of providing such services as agreed between the Company and the fellow subsidiaries, or prices prescribed by the relevant Chongqing government departments.

(v) Purchase of raw materials and spare parts was made at prices determined by reference to transactions of a similar nature contracted with other third party customers of the fellow subsidiaries or a profit mark-up above the cost of providing such products as agreed between the Company and the fellow subsidiaries, or the prices offered by suppliers of such spare parts.

(vi) Purchase of property, plant and equipment was made at prices determined by reference to the prices offered by suppliers of such equipments.

(vii) Rental expenses payable to the Holding Company are in accordance with the lease agreements entered into between the Company and the Holding Company.

(viii) For social welfare expenses which were paid through the Holding Company, no handling fee was charged by the Holding Company.

(ix) Related party transactions with other state-owned enterprises / banks were conducted in the normal course of business at normal commercial terms.

28 RELATED PARTY TRANSACTIONS *(continued)*

(c) Key management compensation

	2005 Rmb'000	2004 Rmb'000
Salaries and other short-term employee benefits	**1,662**	1,532

(d) Year-end balances arising from sales/purchases of goods/services and other transactions

	2005 Rmb'000	2004 Rmb'000
Short-term bank deposits in state-owned banks (Note 12)	**389,453**	626,955
Bank deposits with maturity over 3 months and restricted cash in state-owned banks (Note 11)	**85**	44,483
Receivables due from related parties		
— Fellow subsidiaries of the Holding Company (Note 10)	**68,028**	63,479
— Trade and other receivables from other state-owned enterprises	**222,498**	129,898
	290,526	193,377
Trade and other payables due to related parties		
— The Holding Company (Note 15)	**21,269**	35,001
— Fellow subsidiaries of the Holding Company (Note 15)	**26,398**	20,444
— Trade and other payables to other state-owned enterprises	**227,049**	241,873
	274,716	297,318
Bank borrowings from state-owned banks (Note 16)	**2,013,650**	1,227,650

28 RELATED PARTY TRANSACTIONS *(continued)*

The amounts due from/to the Holding Company and fellow subsidiaries are unsecured, interest-free and have no fixed terms of repayment.

29 EVENTS AFTER THE BALANCE SHEET DATE

As at 31st December 2005, except those disclosed in other notes of the financial statements, the Company had no material events after the balance sheet date.