

Directors' Report

The directors herein present their first annual report and the audited financial statements of China Oriental Group Company Limited ("the Company") for the period from 3 November 2003 (date of incorporation) to 31 December 2003 and the proforma financial statements of the Company and its subsidiaries (hereinafter collectively referred to as the "Group") (legally created on 20 January 2004) for the year ended 31 December 2003.

GROUP REORGANISATION, SUBSIDIARIES AND BASIS OF PRESENTATION

The Company was incorporated as an exempted company with limited liability on 3 November 2003 under the Companies Act 1981 of Bermuda. Pursuant to the reorganisation (the "Group Reorganisation"), as disclosed in the prospectus of the Company dated 18 February 2004 (the "Prospectus"), to rationalise the structure of the Group in preparation for the listing of the Company's shares on the Main Board of The Stock Exchange of Hong Kong Limited (the "Stock Exchange"), the Company became the holding company of other companies now comprising the Group on 20 January 2004. Further details of the Group Reorganisation and the subsidiaries acquired pursuant thereto as well as the basis of presentation of the proforma financial statements are set out in notes 1, 2, 23 and 30 to the proforma accounts.

Following completion of the Group Reorganisation and the global offerings, the Company's shares were listed on the Stock Exchange on 2 March 2004.

In order to apprise the Company's shareholders of the proforma consolidated financial results and position of the Group, as if the Group had been in existence throughout the year ended 31 December 2003, the proforma financial statements are included in this annual report. The basis of preparing the aforesaid proforma financial information, which is detailed in note 1 and 2 to the proforma accounts, is consistently applied for presenting information relating to the Group in this directors' report.

PRINCIPAL ACTIVITIES

As at 31 December 2003, the Company's principal activity is investment holding. Had the Group Reorganisation been completed on 31 December 2003, the principal activity of the Company's principal operating subsidiary would have been the production and sales of iron and steel products. The nature of the principal activity has not changed during the year.

SEGMENT INFORMATION

All the Group's proforma consolidated turnover and contribution to results are derived from PRC and mainly from the production and sales of iron and steel products for the two years ended 31 December 2003 and are set out in note 3 to the proforma accounts.



RESULTS AND DIVIDENDS

The Group's proforma consolidated profit and loss account for the year ended 31 December 2003 and its proforma consolidated balance sheet as at that date, together with the balance sheet of the Company as at 31 December 2003, are set out in the financial statements on pages 33 to 34 and 25.

Prior to the Group Reorganisation and the global offer, the Company did not have any distributable reserves at the balance sheet date.

As the Company was recently listed on the Stock Exchange and the Group was not legally formed on 20 January 2004, the Board of Directors does not recommend the payment of dividend for the period from 3 November 2003 (date of incorporation) to 31 December 2003.

SUMMARY FINANCIAL INFORMATION

A summary of the proforma financial results and assets, liabilities and minority interests of the Group for the last four financial years, is set out on page 67.

FIXED ASSETS

Details of movements in the fixed assets of the Group during the year are set out in note 11 to the proforma accounts.

The fair market value of the parcel of land, various buildings and structures located at the east of Santunying Town, Qianxi County, Hebei Province, PRC at 31 December 2003, was RMB518,382,000, details of which are disclosed in the property valuation report of the Prospectus.

SHARE CAPITAL

Details of the movements in the Company's issued share capital since its incorporation on 3 November 2003, together with the reasons therefor, are set out in note 8 and 12 to the accounts.

RESERVES

The Group did not exist as at 31 December 2003. Details of the movements in the reserves of the Group on proforma basis and the Company during the year are set out in note 23 to the proforma accounts and note 9 to accounts, respectively.



DISTRIBUTABLE RESERVES

At 31 December 2003, the Company did not have any distributable reserves.

PRE-EMPTIVE RIGHTS

There are no provisions for pre-emptive rights under the Company's Bye-laws or the Companies Act 1981 of Bermuda, which would oblige the Company to offer new shares on a pro rata basis to existing shareholders.



MAJOR CUSTOMERS AND SUPPLIERS

The Group did not exist at 31 December 2003. Had the Group Reorganisation been completed, the largest customer of the Group by itself and taken together with the next four largest customers accounted for 7.9% and 30.1% respectively of the Group's proforma consolidated turnover for the year.

The purchases attributable to the five largest suppliers of the Group accounted for less than 30% of the total Group's proforma consolidated purchases for the year.

None of the directors of the Company or any of their associates or any shareholders (which to the best knowledge of the directors, own more than 5% of the Company's issued share capital) had any beneficial interest in the Group's five largest customers.

DIRECTORS

The directors of the Company for the period from 3 November 2003 (date of incorporation) to the date of this report were as follows:

Executive directors

Mr. Han Jingyuan	(appointed on 13 November 2003)
Ms. Chen Ningning	(appointed on 13 November 2003)
Mr. Zhu Jun	(appointed on 23 December 2003)
Mr. Zhu Zijiu	(appointed on 23 December 2003)
Mr. Tang Chi Fai	(appointed on 23 December 2003)

Independent non-executive directors

Mr. Gao Qingju	(appointed on 23 December 2003)
Mr. Yu Tung Ho	(appointed on 23 December 2003)

In accordance with Bye-law 87(1) of the Company, Ms. Chen Ningning and Mr. Zhu Jun will retire by rotation and, being eligible, will offer themselves for re-election at the forthcoming annual general meeting.

Pursuant to 13.51(2) of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Ltd. (the "Listing Rules"), the annual fee specified in each of Ms. Chen Ningning and Mr. Zhu Jun's existing service contracts are RMB100,000. The basis of determining the director's fee is based on mutual negotiation between the Directors. Save as disclosed in this annual report, Ms. Chen Ningning and Mr. Zhu Jun do not have any relationships with any directors, senior management or substantial or controlling shareholders of the Company.

DIRECTORS' INTERESTS IN CONTRACTS

During the year, the Group has purchased raw materials from Pioneer Metals Company Limited ("PMC"), a company in which Ms. Chen Ningning, is interested so as to control the exercise of 50% of the voting power at general meeting of PMC. Further details of the transactions undertaken in connection therewith are included in note 26 to the proforma accounts.

Save as the transactions inherited to the Group Reorganisation as disclosed in the Prospectus and in note 23 and 26 to the proforma accounts, no director had a material interest in any contract of significance to the business of the Group to which the Company or any of its subsidiaries was a party during the year.

DIRECTORS' AND SENIOR MANAGEMENT'S BIOGRAPHIES

Biographical details of the directors of the Company are set out on pages 12 to 14 of the annual report.

DIRECTORS' SERVICE CONTRACTS

Two of the executive directors (including Ms. Chen Ningning) have service contracts with the Company for a fixed term of three years commencing from 13 November 2003, whilst the other three executive directors (including Mr. Zhu Jun) have service contracts with the Company for a fixed term of three years commencing from 23 December 2003. Each of these contracts may be terminated by either party giving not less than three months' notice in writing.

The independent non-executive directors are appointed for a period of one year commencing from 23 December 2003 in accordance with their service contracts.

Save as disclosed above, no director proposed for re-election at the forthcoming annual general meeting has a service contract with the Company which is not determinable by the Company within one year without payment of compensation, other than statutory compensation.

DIRECTORS' INTERESTS AND SHORT POSITIONS IN SECURITIES

Subsequent to the balance sheet date, on 2 March 2004, the Company was listed on the Stock Exchange. Accordingly, at the date of this report, the interests and short positions of the Directors, chief executives and their associates of the Company in the shares, underlying shares and debentures of the Company or any associated corporation (within the meaning of Part XV of the Securities and Futures Ordinance ("SFO")) as recorded in the register required to be kept under Section 352 of the SFO or as otherwise notified to the Company and the Stock Exchange pursuant to the Model Code for Securities Transactions by Directors of Listed companies, were as follows:

Number of shares held and nature of interest in the Company:

	Corporate interest	Total interests	Long/Short Position
Mr. Han Jingyuan	1,282,480,849 <i>(note 1)</i>	44.15%	Long
Ms. Chen Ningning	817,519,151 <i>(note 2)</i>	28.14%	Long

Note 1: At the date of this report, Mr. Han Jingyuan beneficially owns 60.69% of the issued share capital of Wellbeing Holdings Limited ("Wellbeing Holdings") and holds 16.09% of the issued share capital of Wellbeing Holdings on trust for the benefit of certain employees of the subsidiary of the Company. Wellbeing Holdings directly owns 1,230,728,124 shares or 42.37% of the issued shares of the Company. He is also the beneficial owner of 100% of the issued share capital of Chingford Holdings Limited which directly owns 51,752,725 shares or 1.78% of the issued shares of the Company.

Note2: At the date of this report, Ms. Chen Ningning owns 50% of the issued share capital of Smart Triumph Corporation ("Smart Triumph") which directly owns 817,519,151 shares or 28.14% of the issued shares of the Company.

Save as disclosed above, at the date of this report, none of the Directors and chief executives and their associates has any interest and short positions in the shares, underlying shares and debentures of the Company or any associated corporation (within the meaning of Part XV of the Securities and Futures Ordinance ("SFO")) as recorded in the register required to be kept under Section 352 of the SFO or as otherwise notified to the Company and the Stock Exchange pursuant to the Model Code for Securities Transactions by Directors of Listed companies.

DIRECTORS' RIGHTS TO ACQUIRE SHARES OR DEBENTURES

Apart from the transactions related to the Group Reorganisation as disclosed in the Prospectus and as set out in note 23 to the proforma accounts, at no time since the Company's incorporation were rights to acquire benefits by means of the acquisition of shares in or debentures of the Company or any other body corporate granted to any director or their respective spouse or children under 18 years of age, or were any such rights exercised by them; or was the Company or any of its holdings companies, fellow subsidiaries and subsidiaries a party to any arrangement to enable the Company's directors, their respective spouse or children under 18 years of age to acquire such rights in any other body corporate.

CONTRACTS OF SIGNIFICANCE

Save as the transactions inherited to the Group Reorganisation as disclosed in the Prospectus and in note 23 to the proforma account, no controlling shareholder or any of its subsidiaries have any contract of significance with the Company or its subsidiary during the year.

SUBSTANTIAL SHAREHOLDERS

At the date of this report, the interests or short positions of every person, other than a director or chief executive of the Company, in the shares and underlying shares of the Company as recorded in the register required to be kept by the Company under Section 336 of the SFO are as follows:

Name	Number of shares held	Percentage of the Company's issued share capital	Long/short Position
Wellbeing Holdings	1,230,728,124	42.37%	Long
Smart Triumph	817,519,151	28.14% (note1)	Long
Ms. Lu Hui	817,519,151	28.14% (note1)	Long

Note1: At the report date, the interests of Smart Triumph Corporation in the shares of the Company are also attributed to Ms. Lu Hui on the basis that Ms. Lu Hui owns 50% of the issued share capital of Smart Triumph.

Save as disclosed above, at the date of this report, no person, other than a director or chief executive of the Company, had interests or short positions in the shares and underlying shares of the Company required to be kept in the register by the Company under Section 336 of the SFO.

RELATED PARTY AND CONNECTED TRANSACTIONS

Details of significant related party and connected transactions of the Group under the Listing Rules are set out in note 26 to the proforma accounts.

With respect to the purchases of raw material by the Group from PMC as set out in note 26 to the proforma accounts, had the Company been listed in the year of 2003, such transactions would have constituted continuing connected transactions under the Listing Rules. The Stock Exchange has granted a waiver for a period of three financial years ending 31 December 2006 from strict compliance with the connected transaction requirements as set out in the Listing Rules in respect of such transactions. In the opinion of the independent non-executive directors of the Company, the purchases of raw material by the Group from PMC for the year ended 31 December 2003 were:

- (i) entered into by the Group in the ordinary and usual course of its business;
- (ii) not conducted if PMC's offer price is higher than those of other bidders, or if the terms of sales PMC offers are otherwise less favourable to the Group;
- (iii) entered into in accordance with the relevant agreement governing such transactions;
- (iv) on terms that are fair and reasonable and in the interests of the shareholders of the Company as a whole; and
- (v) within the relevant annual cap amounts as agreed by the Stock Exchange.

Save as transactions inherited to the Group Reorganisation and as disclosed in note 26 to the proforma accounts, there were no other transactions required to be disclosed as connected transactions in accordance with the Listing Rules.

PURCHASE, REDEMPTION OR SALE OF LISTED SECURITIES OF THE COMPANY

Pursuant to the over-allotment option referred to in the Prospectus, 105,000,000 shares were issued at the offer price of HK\$2.75 per share on 12 March 2004.

Save as disclosed above, since the listing of the Company's shares on the Stock Exchange on 2 March 2004 and up to the date of this report, neither the Company, nor any of its subsidiaries has purchased, redeemed or sold any of the Company's listed securities.

SUBSEQUENT EVENTS

Details of the significant post balance sheet events are set out in note 28 to the proforma accounts and note 12 to the accounts.

CODE OF BEST PRACTICE

In the opinion of the directors, the Company complied with the Code of Best Practice as set out in Appendix 14 of the Listing Rules, throughout the accounting period covered by the annual report, except that the audit committee was set up on 23 December 2003.

AUDIT COMMITTEE

The Company has set up an audit committee on 23 December 2003 and the terms of reference set out in "A Guide For The Formation Of An Audit Committee" published by the Hong Kong Society of Accountants was adopted as the terms of reference of the audit committee with the exception that the audit committee may have a minimum of two members.

The audit committee provides an important link between the Board and the Company's auditors in matters coming within the scope of the group audit. The audit committee comprises all of the two independent non-executive directors of the Company.

AUDITORS

PricewaterhouseCoopers were appointed as the first auditors of the Company for the period ended 31 December 2003.

PricewaterhouseCoopers retire and a resolution for their reappointment as auditors of the Company will be proposed at the forthcoming annual general meeting.

On Behalf of the Board

CHINA ORIENTAL GROUP COMPANY LIMITED

Han Jingyuan

Chairman and Chief Executive Officer

Hong Kong, 23 April 2004