CHAIRMAN'S STATEMENT

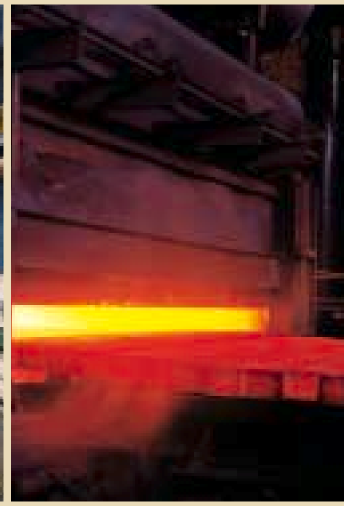
The audited consolidated sales of the Group for the year 2005 was RMB9,183 million, representing an increase of 0.7% as compared with that of 2004, while audited profit attributable to equity holders of the Company was RMB847 million, representing a decline of 28.3% when compared with that of 2004. The audited basic earnings per share for the year 2005 was RMB0.29, which represented a decrease of 32.6% from that of 2004.

Business Review

In 2005, the iron and steel market in the PRC in general witnessed a relatively significant change in the price, which began to decrease since May 2005. The decline in price was substantial when compared with the relatively high levels reached in the first quarter of 2005. The price fall was mainly attributable to the PRC government's implementation of certain austerity measures including the abolition of export tax rebates on billets and measures focusing on the regulation of an overheating real estate industry in April and May 2005. Moreover, there were excessive production capacities in the overall iron and steel market. Due to the aforesaid market conditions, the Group's average selling prices of billets and strips & strip-related products (excluding value-added tax) in the second half of 2005 dropped by 13-23% when compared with those in the first half of 2005.

In 2005, the Group sold approximately 1,458,000 tonnes of billets, 1,848,000 tonnes of strips & strip-related products and 31,000 tonnes cold rolled sheets (2004: approximately 2,006,000 tonnes of billets and 1,379,000 tonnes of strips & strip-related products). Strips & strip-related products accounted for 55.3% of the Group's total sales volume (2004: 40.7%), showing further fine-tuning in product mix of the Group. The Group's average selling prices of billets and strips & strip-related products (excluding value-added tax) were RMB2,491 per tonne and RMB2,917 per tonne respectively in 2005, representing a decrease of 4.2% and an increase of 3.9% when compared with RMB2,599 per tonne and RMB2,808 per tonne in 2004 respectively.

The average cost of sales of the Group's billets and strips & strip-related products in 2005 were RMB2,264 per tonne and RMB2,436 per tonne respectively, representing a decrease of 0.3% and an increase of 4.1% when compared with RMB2,270 per tonne and RMB2,341 per tonne in 2004 respectively.



In 2005, gross profit of billets and strips & strip-related products were RMB227 per tonne and RMB481 per tonne respectively (2004: RMB329 per tonne and RMB467 per tonne respectively). The gross profit in 2005 decreased by 6.6% to RMB1,224 million when compared with that of 2004 (2004: RMB1,311 million).

Awards to the Company and the Management

Hebei Jinxi Iron and Steel Company Limited ("Jinxi Limited"), a subsidiary of the Group, was named as the "Enterprise with Greatest Growth Potential" by the China Enterprise Confederation and the China Enterprise Directors Association in January 2005. Jinxi Limited was named a "Chinese Enterprise with an AAA credit rating in 2005" by the China Institute of Credit Evaluation and the China Quality Standard Research Center in August 2005.

In addition, Mr. Han Jingyuan, the Chairman and the Chief Executive Officer of the Company, was named as "The Most Attention-grabbing Chinese Entrepreneur in 2004" by the China Enterprise Confederation and the China Enterprise Directors Association in January 2005.

Human Resource and Remuneration Policies

As at 31 December 2005, the Group had a workforce of 5,224 (31 December 2004: 4,617) and temporary staff of 1,906 (31 December 2004: 1,792). Staff cost of the Group for the year 2005 approximated to RMB169 million (2004: RMB146 million), representing an increase of 15.6%. The cost included basic salaries and benefits, as well as other staff benefits such as discretionary bonus, medical and insurance plans, pension scheme, unemployment insurance plan and maternity insurance plan. The Group's remuneration policies are designed to tie its employees' income to their production and/ or sales volume, as well as to the extent that they meet the Group's quality control and cost control targets. In order to improve the Group's productivity and further enhance the quality of its workforce, the Group implemented continuing education and training programmes for the management staff and factory workers.

Production Capacity

The annual production capacity of the Group is as follows:

	31 December 2005 *(in tonnes)*	31 December 2004 *(in tonnes)*
Billets	**4,000,000**	3,500,000
Strips	**800,000**	800,000
Mid-width strips	**1,000,000**	1,000,000
Cold rolled sheets	**250,000-400,000**	—

H-section Steel Rolling Line

Production of the entire project is expected to commence in June 2006. The project is expected to have an annual production capacity of 1 million tonnes of H-section steel.

Investment in Foshan Jin Xi Jin Lan Cold Rolled Sheet Co., Ltd. ("Foshan Jinxi")

Foshan Jinxi commenced trial production in May 2005. As at 31 December 2005, the annual production capacity (depends on the product specification of the product produced) of cold rolled sheets was approximately 250,000 tonnes to 400,000 tonnes while that of galvanized sheets was approximately 150,000 tonnes to 180,000 tonnes.

During the year ended 31 December 2005, Foshan Jinxi was mainly in the trial production and initial market development stage, and therefore its contribution to the Group's sales during 2005 was insignificant.

Dividend Policy

The Company intends to distribute not less than 20% of the Group's distributable profit as dividend for the periods subsequent to its listing, but the actual amount of dividend and its percentage to the profit will be at the discretion of the Board and will depend upon the Company's future operation and earnings, capital requirement and surplus, general financial condition, contractual restrictions and other factors that the Board deem relevant. In addition, pursuant to relevant PRC law, Jinxi Limited's distributable profit should not be higher than its net profit after allocations made to the statutory reserve and welfare funds as determined by the generally accepted accounting principles in the PRC.

Capital Structure

The cash and bank balances (including restricted bank balances) of the Group as at 31 December 2005 was RMB1,725 million (31 December 2004: RMB2,926 million).

The current ratio was 1.22 as at the end of 2005 (31 December 2004: 1.69).

As at 31 December 2005, the Group's borrowings repayable within one year and borrowings repayable after one year amounted to RMB1,336 million and RMB294 million respectively (31 December 2004: RMB1,458 million and RMB459 million respectively).

The consolidated interest expenses in 2005 amounted to RMB74,189,000 (2004: RMB64,270,000). The interest coverage was 14.5 times (2004: 19.3 times).

As at 31 December 2005, the ratio between total liabilities and total assets of the Group was 42.0% (31 December 2004: 46.5%).

To conclude, the financial position of the Group was healthy.

Use of Proceeds from Global Offering

In March 2004, the Company issued 805,000,000 shares at HK$2.75 per share by way of global offering and over-allotment. The net proceeds after deducting the relevant expenses were approximately HK$2,107 million.

During the period from the date of listing to 31 December 2005, the use of net proceeds from the listing as stated in the Prospectus was as follows:

	RMB million
Construction of mid-width strip rolling line	103.7
Coal powder blowing technique	3.2
Energy recycling for power generation	9.5
Construction of the H-section steel rolling line	1,005.7
Construction of a $530m^3$ blast furnace	133.2
Construction of two 50 tonnes converter furnaces	86.8
General corporate purposes (including working capital, repayment of borrowings and investment in the authorized capital of Foshan Jinxi)	891.3
	2,233.4

As at 31 December 2005, the Group had utilised all the proceeds from the global offering on the aforesaid construction projects and for general corporate purpose.

Capital Commitments

As at 31 December 2005, the Group had capital commitments amounted to RMB256 million (31 December 2004: RMB1,445 million), which mainly consisted of the capital commitments of the construction of the H-section steel rolling line and other projects. Such capital commitments will be financed by the Group's internal resources and/ or bank borrowings.

Guarantees and Contingent Liabilities

As at 31 December 2005, the Group's contingent liabilities amounted to RMB277 million (31 December 2004: RMB396 million), which mainly consisted of the guarantees for the letter of credit issued by an agent that appointed by the Group to import machinery and equipment on behalf of the Group.

Pledge of Assets

As at 31 December 2005, the net book value of the Group's land use rights, buildings and machinery pledged as the Group's bank borrowings amounted to approximately RMB635 million (31 December 2004: RMB494 million).

As at 31 December 2005, the book value of inventories pledged as security for the Group's notes payables amounted to approximately RMB32 million (2004: nil).

Save as disclosed in this report, there are no other pledged assets.

Exchange Risks

As at 31 December 2005, Renminbi, US dollar and HK dollar accounted for 28.9%, 71.0% and 0.1% of the Group's total bank balance respectively (31 December 2004: 26.3%, 73.3% and 0.4% respectively).

As majority of the sales, purchases of raw materials and bank borrowings committed by the Group were mainly in Renminbi in 2005 and 2004, the Group's exposure to foreign exchange risk remained relatively low. In light of the construction of H-section steel rolling line, the Group had entered into project and equipment contracts of approximately Euro 42.9 million. In 2005, the Group has entered into Euro Dollar forward contract to hedge against partial exchange rate risk exposure.

Interest Rate Risks

The interest rates of the Group's certain borrowings are subject to variations. The risk of increasing interest rate will increase the interest costs of both new borrowings and existing borrowings. At present, the Group does not use any derivatives to hedge its interest rate risk exposure.

Post Balance Sheet Events

Saved as disclosed in this report of the Group, there are no events to cause material impact on the Group from the balance sheet date to the date of this report.

Prospects

Looking into 2006, oversupply will continue in the overall iron and steel market, it is expected that the prices of steel products will experience minor rather than drastic fluctuations due to the following expectation. Firstly, the prices of steel products in the iron and steel industry have already dropped significantly in the second half of 2005. Secondly, relatively stringent macroeconomic austerity measures are not expected to be introduced. Thirdly, the PRC economy is expected to continue with stable development. In the long run, the iron and steel industry in the PRC will sustain a healthy development, with the continuous growth in the PRC economy, consolidation of the iron and steel industry, and the PRC Government's policy to eliminate obsolete production capacities in the iron and steel industry.

With regard to the raw materials, the supply and demand of domestic coke and iron powder remains basically balanced and their prices are expected to experience minor adjustments only. On the other hand, there is a rising trend for the price of imported iron powder.

The Group's product mix will further be improved after the expected commencement of the production of the H-section steel rolling line in June 2006 and the expected addition of a strip production line of 500,000 tonnes in 2006.

On Behalf of the Board
China Oriental Group Company Limited

Han Jingyuan
Chairman and Chief Executive Officer

Hong Kong, 30 March 2006