

Prospects

The Group has successfully attained a leading position in the China special steel industry. As the machinery and equipment manufacturing industries continue to grow, there is a corresponding growing demand for special steel. The second half of 2006 is expected to see a steady growth in sales volume. The Company will closely monitor any changes in the market and continuously expand its market share in its higher margin products. Procurement management will be reinforced to ensure the quality of raw materials and to reduce procurement costs. The company is committed to technical innovation to improve product quality and reduce costs.

In July 2006, we have completed the equipment refinement project which increased our iron-making annual production capacity from 200,000 tonnes to 400,000 tonnes thus relieving our bottleneck in production. Furthermore, the major transaction of capital injection (“Capital Injection”) in Anyang Steel Group Luoyang Anlong Steel Company Limited (安陽鋼鐵集團洛陽安龍鋼鐵有限公司) (“Anlong Steel”) has been approved by the Company’s shareholders at the Extraordinary General Meeting held on 18 September 2006. Since the listing of the Company in May 2005, the Group has been planning to expand its business both organically and by acquisitions. The Capital Injection in Anlong Steel is consistent with the Group’s future plans and acquisition strategy to expand the Group’s production capacity at low acquisition costs. Leveraging on the Group’s technical know-how and experience in using generic steel production equipment to produce special steel, the Capital Injection presents an opportunity for the Company to make use of its innovative proprietary know-how to convert Anlong Steel from a loss-making generic steel producer to a manufacturer of high quality special steel which commands higher margin as compared with generic steel. We considered that the Capital Injection will have the following advantages:

- (a) *Enhancing production capacity:* Following the Capital Injection and the subsequent conversion of Anlong Steel’s production line, the Group will be able to gradually increase its designed production capacity for special steel from 500,000 tonnes to 800,000 tonnes and for iron-making from 400,000 tonnes to 700,000 tonnes. The increased capacity will allow the Company to further leverage on its cost advantage in sourcing iron ore and other raw materials. The increased economy of scale is expected to lead to greater operational efficiency and lower operating and maintenance costs.

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The Group believe that the expansion in operations and production scale will enhance the Group's market share, product mix and overall competitiveness in the PRC steel industry;

- (b) *Strategic location:* Anlong Steel is situated near major transportation networks of road and railways in Luoyang city, Henan Province of PRC and is in close proximity with Yongtong Special Steel, thereby facilitating the transport of raw materials and finished products as well as reducing the logistical costs; and
- (c) *Strengthening market position:* We expect that Anlong Steel will make positive contributions to the Group's revenue and earnings and therefore strengthen the Group's operational and financial performance. In short, we consider that the Capital Injection will represent a milestone of the Group in its expansion of its special steel business and allow the Company to consolidate further its market position in the PRC.

The Group also signed an agreement on 18 September 2006, with INTECO Special Melting Technologies Ltd. ("INTECO"), an Austria world-known special steel technical consultant company, for a period of 7 years. Pursuant to the agreement, INTECO will provide exclusive technical assistance services to the Group, and designate several engineers as the Group's technical consultants, as well as delegate a senior engineer as the Group's technical supervisor. With the implementation of the agreement, the Group will further upgrade the quality of its bearing steel to world-class level and bring its business a bright prospect.