1. REVIEW OF OPERATIONS

In 2006, the Company overcome various unfavourable factors such as raw material increase, significant fluctuations in steel market price, which demonstrated the strength and the success of its business reorganisation. The Company continued to enhance proprietary innovation and its corporate development. The Company achieved all its production management tasks and certain new breakthroughs, laying a solid foundation for making itself an internationally competitive iron and steel enterprise.

(1) Operating Results

Based on the IFRS, for the year ended 31 December 2006, the Group recorded a net profit of Rmb7,094 million for the year ended 31 December 2006, representing an increase of 235.10% in comparison with the previous year, and its basic earnings per share was Rmb1.196.

Based on the PRC Accounting Rules and Regulations, for the year ended 31 December 2006, the Group recorded a net profit of Rmb6,845 million representing an increase of 229.24% in comparison with the previous year, and its basic weighted average earnings per share was Rmb1.204 and diluted earnings per share was Rmb1.154.

(2) Analysis of the Group's Financial and Operational Status

Based on the PRC Accounting Rules and Regulations:

Unit: Rmb million

Item	**2006**	2005	Change (%)
Total assets	**58,430**	14,290	308.89
Long-term liabilities	**11,413**	604	1789.57
Shareholders' funds	**29,834**	11,329	163.34
Income from principal operations	**54,596**	26,488	106.12
Profit from principal operations	**12,980**	3,755	245.67
Net profit	**6,845**	2,079	229.24
Net increase/(decrease) in cash and cash equivalents	**1,136**	(2,186)	151.97

1. REVIEW OF OPERATIONS *(continued)*

(2) Analysis of the Group's Financial and Operational Status *(continued)*

Based on the IFRS:

Unit: Rmb million

Item	2006	2005	Change (%)	Reason for change
Total assets	**58,936**	14,224	314.34	A
Non-current liabilities	**11,413**	604	1789.57	B
Total equity attributable to equity shareholders of the Company	**30,001**	11,251	166.65	C
Turnover	**54,596**	26,488	106.12	D
Gross profit	**12,936**	3,724	247.37	D
Profit for the year and attributable to equity shareholders of the Company	**7,094**	2,117	235.10	D
Net increase / (decrease) in deposit with banks, cash and cash equivalents	**1,138**	(1,264)	190.03	E

Notes:

A. The increase in total assets was mainly attributable to i) the acquisition of 100% equity interest of ANSI; ii) the increase in net profit; and iii) the increase in engineering expenditure.

B. The increase in non-current liabilities was mainly attributable to i) the consolidation of the existing liabilities of ANSI as a result of the Company's acquisition of 100% equity interest; ii) the deferred payment for the remaining balance of the purchase consideration for the acquisition of ANSI; and iii) the increase in loans for construction projects.

C. The increase in equity attributable to equity shareholders of the Company was attributable to i) the issuance of 2.97 billion shares to Angang Holding at premium (Rmb4.29 per share), and ii) the increase in net profit generated from operations.

D. The increase in turnover, gross profit and profit attributable to equity shareholders of the Company was attributable to i) the expansion in the scale of the Company's production and sales volume as a result of the acquisition of 100% equity interest of ANSI by the Company, ii) the impact of technical innovation projects of the Company such as the 2130 cold rolling project achieving their performance target, iii) the expansion of the Company's product portfolio, the increase in the proportion of sales of higher value-added products and expansion in exports and iv) the decrease in production cost resulting from the implementation of various cost control and management measures.

1. REVIEW OF OPERATIONS *(continued)*

(2) Analysis of the Group's Financial and Operational Status *(continued)*

E. The increase in deposit with banks, cash and cash equivalents was mainly attributable to i) the increase of Rmb7,673 million in the net cash flow from operating activities as compared with the previous year due to the increase in net profit from operating activities and operating payables, ii) the increase of Rmb10,149 million in net cash outflows from investment activities as compared with the previous year due to the increase in cash expenditures from investment and the increased acquisition of fixed assets and expenditures in construction in progress, and iii) the increase of Rmb4,878 million in net cash flow from financing activities due to factors such as increased cash received from borrowings.

(3) Analysis of the changes of financial figures of the Group's assets and expenses (based on the PRC Accounting Rules and Regulations)

Unit: Rmb million

Item of Balance Sheet	**31 December 2006** Amount	**31 December 2006** As a percentage in total assets (%)	31 December 2005 Amount	31 December 2005 As a percentage in total assets (%)	Increase/ (decrease) of percentage in total assets compared with previous year(%)
Receivables and Prepayments	**2,735**	**4.68**	1,371	9.59	(4.91)
Inventory	**7,220**	**12.36**	2,608	18.25	(5.89)
Fixed assets, at cost	**41,471**	**70.98**	11,438	80.04	(9.06)
Accumulated depreciation	**8,447**	**14.46**	4,905	34.32	(19.86)
Construction in progress	**8,279**	**14.17**	2,840	19.87	(5.70)
Intangible assets	**5,528**	**9.46**	334	2.34	7.12
Short-term loans	**4,630**	**7.92**	117	0.82	7.10
Long-term loans	**9,089**	**15.56**	604	4.23	11.33
Share capital	**5,933**	**10.15**	2,963	20.73	(10.58)
Undistributed profit	**8,826**	**15.11**	3,732	26.12	(11.01)

1. REVIEW OF OPERATIONS *(continued)*

(3) Analysis of the changes of financial figures of the Group's assets and expenses (based on the PRC Accounting Rules and Regulations) *(continued)*

Notes:

1) The decrease in accounts receivables and prepayments as a percentage of total assets in 2006 when compared to 2005 was attributable to: the Company's sales were mainly settled through advance payment and only a few key tender project customers were entitled to pay after products were delivered and as a result of the Company's acquisition of 100% equity interest of ANSI, the Company's production and sales scale and total assets increased while accounts receivable as a percentage of total assets decreased by 3.05 percentage points.

2) The decrease in inventory as a percentage of total assets in 2006 when compared to 2005 was attributable to the decrease by 4.85 percentage points of finished product stock as a percentage of total assets, which was in turn due to the increase in total assets as a result of acquistion of 100% equity interest of ANSI and the completeness of the production chain of the Company.

3) The decrease in fixed assets at cost and accumulated depreciation as a percentage of total assets in 2006 when compared to 2005 was due to the accounting impact as a result of the acquired assets being stated at valuation upon the acquisition of 100% equity interest of ANSI.

4) The decrease in construction in progress as a percentage of total assets in 2006 when compared to 2005 was due to a significant part of construction in progress being transferred into fixed assets during the period.

5) The increase in the intangible assets as a percentage of total assets in 2006 when compared to 2005 was due to the significant amount of land use right being included in the acquired assets of ANSI.

6) The increase in short-term loans and long-term loans as a percentage of total assets in 2006 when compared to 2005 was due to consolidation of existing loans of ANSI as a result of the Company's acquisition of 100% equity interest in ANSI, and new project loans to finance the significant project expenditures during the period.

7) The decrease in share capital as a percentage of total assets in 2006 when compared to 2005 was attributable to the issuance of 2.97 billion shares to Angang Holding at premium (Rmb4.29 per share), leading to the increase of Rmb2.97 billion in share capital compared with the acquisition consideration of Rmb19.712 billion. The capital reserves increased by Rmb9.753 billion due to premium over share capital, and the difference between the total consideration and consideration shares is payable to Angang Holding as deferred consideration over three years.

8) The decrease in undistributed profit as a percentage of total assets in 2006 when compared to 2005 was due to the increase in cash dividend distribution and increase in the percentage of loans during the year.

1. REVIEW OF OPERATIONS *(continued)*

(3) Analysis of the changes of financial figures of the Group's assets and expenses (prepared in accordance with PRC Accounting Rules and Regulations) *(continued)*

Unit: Rmb million

Item of Income Statement	2006	2005	Increase compared with previous year%
Operating expenses	**959**	463	107.13
Administrative expenses	**1,527**	349	337.54
Financial expenses	**901**	64	1307.81
Income tax	**2,368**	903	162.24

Notes:

1) The increase in operating expenses was due to i) the expansion in its corporate scale and the increase in sales volume resulting from acquisition of 100% equity interest of ANSI, ii) the increase in selling expenses arising from increase of product sales due to the enhanced performance on completion of technical innovative projects such as 2130 cold roll project, and iii) the increase in export expenses as a result of the increase in export of products in order to capture a larger international market share.

2) The increase in administrative expenses was due to the expansion in corporate scale as a result of the acquisition of 100% equity interest of ANSI.

3) The increase in financial expenses was due to i) consolidation of the existing loans and interest expenses of ANSI upon acquisition of the 100% equity interest in ANSI, and ii) the interest accrued on deferred consideration payable to Angang Holding in connection with the acquisition of ANSI.

4) The increase in income tax was attributable to the increase in total profit.

1. REVIEW OF OPERATIONS *(continued)*

(4) Analysis of components of cash flow generated from the Group's operating activities, investing activities and financing activities (based on the PRC Accounting Rules and Regulations)

Unit: Rmb million

Item	2006	2005	Main reason for change
Net cash flows from operating activities	**11,084**	2,553	The increase in net cash inflow from operating activities was mainly due to the increase in net profit from operations and the increase in operating payables.
Net cash flows from investing activities	**(11,873)**	(2,656)	The increase in net cash outflows from investing activities was due to acquisition of fixed assets and the increased expenses in construction in progress and the increase in external investment expenditures.
Net cash flows from financing activities	**1,927**	(2,096)	The increase in net cash flows from financing activities was mainly due to the increased cash from loans to finance the increased technical innovation expenditures.

1. REVIEW OF OPERATIONS *(continued)*

(5) Number of Employees of the Company, Employees' Qualifications, Salary Policy and Training Programmes of the Company

As of 31 December 2006, the Company had 31,842 employees, among whom 19,692 were production staff, 78 were sales staff, 2,610 were technicians, 297 were accounting staff and 2,130 were administration personnel. Of the Company's employees, 4,393 had bachelor or higher degrees, representing 13.8% of the total number of the employees; 5,230 had diplomas, representing 16.4% of the total number of the employees and 13,465 had secondary education, representing 42.3% of the total number of the employees.

In 2006, the Company provided variegated training programmes to address different needs of its employees. The training programs for management personnel focused on management concepts, management knowledge and political theory knowledge. The training programs for administration staff and technicians focused on business expertise, computer and foreign languages; and the training programs for production staff were focused on position-specific skills and safety. As a result of these trainings, the overall staff quality was improved, phasing the Company in a better position to achieve production and operation targets in 2006.

The Company has adopted a role and performance-based annual remuneration packages for the senior management; role-based linked remuneration and incentive packages for research personnel; sales / profit-linked remuneration package for sales personnel; and role-based remuneration packages for other personnel.

2. IMPACT OF TAX RATE, EXCHANGE RATE AND INTEREST RATES

On 14 September 2006, five PRC ministries and commissions including the Ministry of Finance jointly issued a document of Cai Shui [2006] No.139 which specified that the export tax refund rate of steel products (142 tax serial no.) was reduced from 11% to 8%, leading to an increase of Rmb58.45 million in the Company's cost and expenses. The Enterprise Income Tax Law of the People's Republic of China promulgated by President's Order No. 63 of the People's Republic of China shall come into force on 1 January 2008. According to the new enterprise income tax law, the enterprise income tax rate shall be 25%. Currently, the Company's income tax rate is 33%, and as a result of the decrease in enterprise income tax rate on 1 January 2008, its net profit is expected to increase.

The People's Bank of China raised the base interest rate of one-year loans of financial institutions from 5.58% to 5.85% on 28 April 2006, representing an increase of 0.27 percentage points. Interest rates of other tiers of loans were accordingly adjusted. According to its then borrowing level, the Company's financial expenses increased by Rmb4 million. The People's Bank of China again raised the base interest rate of one-year loans of financial institutions from 5.85% to 6.12% on 19 August 2006, representing an increase of 0.27 percentage points. Interest rates of other tiers of loans were accordingly adjusted and the increase margin of long-term interest rates was higher than that of short-term interest rates. According to its then borrowing level, the Company's financial expenses increased by Rmb1.23 million. The People's Bank of China again raised the base interest rate of one-year loans of financial institutions from 6.12% to 6.39% on 18 March 2007, representing an increase of 0.27 percentage points. Interest rates of other tiers of loans were accordingly adjusted. According to its then borrowing levels, the Company's financial expenses increased by Rmb7.81 million.

The Company exported some of its products and imported some of its raw materials, equipment, spare parts and materials. Thus, the export and import activities of the Company basically hedged against each other and these is no significant foreign exchange risk.

3. INVESTMENT OF THE COMPANY

(1) External Investments

The Company's external investment for 2006 amounted to Rmb353.33 million, representing an increase of 14,147.18% from Rmb2.48 million in the last year.

The Company invested Rmb237.87 million, Rmb50 million, Rmb47.82 million and Rmb17.64 million in ANSC-TKS, ANSC-Xinchuan Heavy Industries Dalian Steel Product Processing and Distribution Company Limited, TKAS-SSC, and TKAZ (Changchun) Tailored Blanks Limited respectively.

(2) Use of proceeds

In March 2000, the Company issued convertible debentures in the principal amount of Rmb1,500 million, raising a total of Rmb1,480 million, in the PRC. In January 2006, the Company issued 29.7 billion shares to Angang Holding, raising a total of Rmb12.723 billion after deducting issue cost in the PRC.

Unit: Rmb million

Total proceeds	14,203
Total use of proceeds during the year	12,723
Total accumulated use of proceeds	14,203

Projects undertaken	Proposed investment	Changes in use of proceeds	Actual investment	Actual (estimated) benefits	Whether progressing as scheduled and estimated return
Renovation of cold roll line	1,950	No	1,586	741	Yes
Cold Roll Plant's renovation of No. 2 and 3 cross cutting lines	100	No	33	125	Yes
Cutting and Distribution centre for the Cold Roll Plant	180	No	—	Estimated 15.66%	No
Acquisition of 100% equity interest of ANSI	19,712	No	19,712	Included in financial statements of the Company	Yes
Total	21,942	—	21,331	866	—

Reason for the failure in keeping in line with the schedule and estimated return:	The delay in completion of the cutting and distribution centre for the cold roll plant was due to further analysis being required with respect to the Company's project plans.
Reason and procedures for the change	—

3. INVESTMENT OF THE COMPANY *(continued)*

(3) Status of investment of non-publicly raised funds

Unit: Rmb million

Item	Estimated amount	Progress	Return
2130 cold rolling production line	2,640	Completion and commencement for operation	130
Renovation of Chemical Plant	3,749	48%	330
1450 Project in West Area	2,900	30%	—
Bayuquan Iron and Steel Plant	22,600	23%	—
Total	31,889	—	460

4. LIQUIDITY, FINANCIAL RESOURCES AND CAPITAL STRUCTURE OF THE GROUP (IFRS)

As of 31 December 2006, the Group had long-term loans of Rmb9.089 billion (exclusive of loans due within one year) with annual interest rates ranging from 5.184% to 6.156%, repayment periods ranging from 2 to 24 years becoming due between 2008 to 2030. The loans were mainly used for technical innovation projects and the construction of the Bayuquan Iron and Steel Plant. The Group's long-term liabilities due within one year amounted to Rmb5.078 billion. With good credit standing and high product profitability, the Group expects to have sufficient cash to repay the existing liabilities when they fall due in the future.

As of 31 December 2006, the Group's cash and cash equivalents increased by Rmb1,136 million from Rmb562 million in 2005 to Rmb1,698 million in 2006. This was mainly attributable to the increase of cash flow of Rmb10,127 million from operating activities, and the decrease of cash outflow of Rmb11,888 million from investment activities, and the increase of cash flow of Rmb2,899 million from financing activities, and the decrease of cash flow of Rmb2 million due to exchange rate changes.

As of 31 December 2006, the Group's total assets less current liabilities amounted to Rmb41,414 million, as compared with Rmb11,855 million in the previous year. The shareholders' fund of the Group amounted to Rmb30,001 million in 2006, compared with Rmb11,251 million as at 31 December 2005.

5. ASSET PLEDGED

ANSC-TKS Dalian pledged its trade receivables, land use rights, construction in progress, properties, buildings and machinery and equipment to the Bank of China as security for its loans from the Bank of China. In addition, the Company pledged its 50% equity interests in ANSC-TKS Dalian to the Bank of China.

6. CAPITAL COMMITMENTS AND CONTINGENT LIABILITIES

As at 31 December 2006, the Group had capital commitments of Rmb28,027 million, primarily for the construction and improvement of production lines.

As at 31 December 2006, the Group did not have any contingent liability.

7. FOREIGN EXCHANGE RISK

The Company exported some of its products and it also imported certain raw materials, equipment, spare parts and materials. The export and import activities on the Company basically hedged against each other and there is no significant foreign exchange risk.

8. GEARING RATIO

Based on the IFRS, the ratio of the Group's shareholders' funds to liabilities in 2006 was 1.04 times, in comparison with 3.78 times in 2005.