

DIRECTORS' REPORT

The directors (the "Director") of China Oriental Group Company Limited (the "Company") herein present their annual report and the audited financial statements of the Company and its subsidiaries (hereinafter collectively referred to as the "Group") for the year ended 31 December 2006.

REORGANISATION AND BASIS OF PREPARATION

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 "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 the then companies comprising the Group on 20 January 2004. The basis of preparation of the audited financial statements are set out in Notes 1 and 2 to the consolidated financial statements.

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

PRINCIPAL ACTIVITIES

As at 31 December 2006, the Company's principal activity is investment holding. The principal activity of the Group is the manufacture and sales of iron and steel products. The nature of the principal activity has not changed during the year.

SEGMENT INFORMATION

Over 90% of the Group's consolidated sales and contribution to results are derived from the PRC and mainly from the production and sales of iron and steel products for the year ended 31 December 2006 and are set out in Note 5 to the consolidated financial statements.

RESULTS AND DIVIDENDS

The Group's consolidated income statement for the year ended 31 December 2006 and its consolidated balance sheet as at that date, together with the balance sheet of the Company as at 31 December 2006, are set out in the financial statements on pages 33 to 36.

At a meeting held on 3 April 2007, the Directors proposed a final dividend of HK\$133,630,000 (approximately RMB132,150,000), representing HK4.6 cents per ordinary share to the shareholders of the Company whose names appear on the register of members of the Company on 22 May 2007. Subject to the approval of the Company's shareholders at the Company's forthcoming annual general meeting to be held on 22 May 2007, the final dividend will be paid on 12 June 2007.

SUMMARY OF FINANCIAL INFORMATION

A summary of the consolidated financial results and assets, liabilities and minority interest of the Group for the last five financial years, is set out on page 95.

PROPERTY, PLANT AND EQUIPMENT

Details of movements in the property, plant and equipment of the Group and the Company during the year are set out in Note 7 to the consolidated financial statements.

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SHARE CAPITAL

Details of the movements in the Company's issued share capital during the year are set out in Note 17 to the consolidated financial statements.

RESERVES

Details of the movements in the reserves of the Group during the year are set out in Note 18 to the consolidated financial statements.

DISTRIBUTABLE RESERVES

At 31 December 2006, the Company's accumulated losses amounted to RMB39,643,000 (2005: RMB8,319,000).

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 sales attributable to the five largest customers of the Group accounted for less than 30% of the total Group's consolidated revenue for the year.

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

DIRECTORS

The Directors during the year and up to the date of this report were as follows:

Executive Directors

Mr. Han Jingyuan
Ms. Chen Ningning
Mr. Zhu Jun
Mr. Tang Chi Fai
Mr. Liu Lei
Mr. Shen Xiaoling

Independent non-executive Directors

Mr. Gao Qingju
Mr. Yu Tung Ho
Mr. Wong Man Chung, Francis

In accordance with Bye-law 87(1) of the Company and the Rules Governing the Listing of Securities on the Stock Exchange (the "Listing Rules"), Messrs Zhu Jun and Wong Man Chung, Francis 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 Listing Rules, the annual fee specified in each of Messrs Zhu Jun, and Wong Man Chung, Francis's existing service contracts are HK\$300,000 and HK\$300,000 respectively. The basis of determining the Director's fee was based on the mutual negotiation between the Directors with reference to the range of prevailing directors' fee for directors of listed companies in Hong Kong. Mr. Zhu Jun owns approximately 2.82% of shares in Wellbeing Holdings Limited ("Wellbeing Holdings"), a controlling shareholder of the Company. Save as disclosed in this annual report, Messrs Zhu Jun and Wong Man Chung, Francis do not have any relationships with any directors, senior management or substantial or controlling shareholders of the Company.

DIRECTORS' REPORT

DIRECTORS *(Continued)*

The Company has received, from each of the independent non-executive Directors, an annual confirmation of his independence pursuant to Rule 3.13 of the Listing Rules. The Company considers all of the independent non-executive Directors are independent.

DIRECTORS' INTERESTS IN CONTRACTS

Save as the transactions as disclosed in Note 35 to the consolidated financial statements, 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 and senior management of the Company are set out on pages 17 to 20 of the annual report.

DIRECTORS' SERVICE CONTRACTS

Two of the executive Directors have service contracts with the Company for a fixed term of three years commencing from 13 November 2006. Mr. Zhu Jun (an executive Director) has a service contract with the Company for a fixed term of three years commencing from 23 December 2006. Mr. Tang Chi Fai (an executive Director) has a service contract with the Company for a fixed term of one year commencing from 23 December 2006. The remaining two executive Directors have service contracts with the Company for a fixed term of 2 years commencing from 29 September 2006 and 3 years commencing from 1 July 2005, respectively. Each of these contracts may be terminated by either party giving not less than three months' notice in writing.

Two of the independent non-executive Directors have service contracts for a period of one year commencing from 23 December 2006. Mr. Wong Man Chung, Francis (an independent non-executive Director) has a service contract for a period of one year commencing from 25 August 2006.

Mr. Han Jingyuan, Mr. Zhu Jun and Mr. Shen Xiaoling (executive directors of the Company and its subsidiary) have service contracts with the Company's subsidiary on 9 June 2003 for a fixed term of five years commencing from 9 June 2003 which are exempted under the Listing Rules. Actual amount of salary was not specified in the service contracts other than the clause which stated that after probation, the employees will be paid according to the salary of the post. The service contracts may be terminated by the Company's subsidiary by paying compensation equivalent to the unfulfilled contract's salary and one month's salary for each year of service completed.

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' REPORT

DIRECTORS' INTERESTS AND SHORT POSITIONS IN SECURITIES

At 31 December 2006, 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	Percentage of the Company's issued share capital	Long/ Short Position
Mr. Han Jingyuan	1,282,480,849 (Note 1)	44.15%	Long
Ms. Chen Ningning	817,519,151 (Note 2)	28.14%	Long

Notes:

1. At 31 December 2006, Mr. Han Jingyuan beneficially owned 60.69% of the issued share

capital of Wellbeing Holdings and held 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 beneficially owned 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 beneficially owned 51,752,725 shares or 1.78% of the issued shares of the Company at 31 December 2006.

2. At 31 December 2006, Ms. Chen Ningning beneficially owned 100% of the issued capital of Pioneer Iron & Steel Group Company Limited which in turn owned 100% of the issued share capital of Smart Triumph Corporation ("Smart Triumph"). Smart Triumph owned 817,519,151 shares or 28.14% of the issued shares of the Company.

Save as disclosed above and in the section of "Equity-settled share option scheme" below, at 31 December 2006, none of the directors and chief executives and their associates had 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 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' REPORT

EQUITY-SETTLED SHARE OPTION SCHEME

The Company has a share option scheme for all directors and any employees of any company in the Group or any entity in which any member of the Group holds an equity interest. The purpose of the share option scheme is to provide the above persons with the opportunity to acquire proprietary interests in the Company and to encourage the above persons to work towards enhancing the value of the Company and its shares for the benefit of the Company and its shareholders as a whole. The option period is to be determined and notified by the board of directors of the Company (the "Board") to each grantee at the time of making an offer which shall not expire later than ten years from the date of grant. There are no minimum periods for which an option granted must be held and/or minimum performance targets that must be reached before the option can be exercised in whole or in part, unless the Board otherwise determines.

The total number of shares of the Company issued and to be issued upon exercise of the options granted and to be granted to each of the above persons in any 12-month period must not exceed 1% of the shares of the Company in issue without the approval of the shareholder of the Company. Where any grant of options to a substantial shareholder or an independent non-executive Director of the Company, or any of their respective associates, would result in the shares issued and to be issued upon exercise of all options already granted and to be granted to such person in the 12-month period up to and including the date of such grant:

(i) representing in aggregate over 0.1% of the shares of the Company in issue; and

(ii) having an aggregate value, based on the closing price of the shares of the Company on the date of grant, in excess of HK\$5 million,

such grant of options shall be approved by shareholders of the Company.

Upon acceptance of the offer, HK\$1 should be paid by each of the above persons to the Company as consideration for the options granted.

The subscription price shall be such price determined by the Directors of the Company at its absolute discretion and shall be no less than the highest of: (a) the closing price of the shares of the Company on the date of grant; (b) the average closing price of the shares of the Company for the 5 business days immediately preceding the date of grant; and (c) the nominal value of a share on the date of grant.

The above share option scheme shall be valid and effective for a period of 10 years commencing on 23 June 2006 and ending on 22 June 2016 (both days inclusive).

At 31 December 2006 and 3 April 2007, the number of shares to be issued upon exercise of the options which had been granted and remained outstanding under the stock option scheme was 24,200,000, representing 0.8% of the issued share capital at those dates.

At 31 December 2006 and 3 April 2007, the number of shares available for issue under the scheme (excluding the above options which had been granted and remained outstanding) was 266,300,000 shares, representing 9.2% of the issued share capital at those dates.

DIRECTORS' REPORT

EQUITY-SETTLED SHARE OPTION SCHEME (Continued)

Details of the share options outstanding during the year were as follows:

	No. of options outstanding at 1 January 2006	No. of options granted during the year	Date of grant	Exercisable period	No. of options exercised/ cancelled/ lapsed during the year	No. of options outstanding at 31 December 2006	Exercise price per share HK\$	Closing price per share immediately before the date of grant HK\$
Mr. Han Jingyuan	—	2,800,000	30 June 2006	30 June 2006 to 29 June 2016	—	2,800,000	1.76	1.74
Ms. Chen Ningning	—	2,600,000	30 June 2006	30 June 2006 to 29 June 2016	—	2,600,000	1.76	1.74
Mr. Zhu Jun	—	2,400,000	30 June 2006	30 June 2006 to 29 June 2016	—	2,400,000	1.76	1.74
Mr. Tang Chi Fai	—	2,400,000	30 June 2006	30 June 2006 to 29 June 2016	—	2,400,000	1.76	1.74
Mr. Liu Lei	—	2,400,000	30 June 2006	30 June 2006 to 29 June 2016	—	2,400,000	1.76	1.74
Mr. Shen Xiaoling	—	2,400,000	30 June 2006	30 June 2006 to 29 June 2016	—	2,400,000	1.76	1.74
Mr. Yu Tung Ho	—	2,400,000	30 June 2006	30 June 2006 to 29 June 2016	—	2,400,000	1.76	1.74
Mr. Gao Qingju	—	2,400,000	30 June 2006	30 June 2006 to 29 June 2016	—	2,400,000	1.76	1.74
Mr. Wong Man Chung, Francis	—	2,400,000	30 June 2006	30 June 2006 to 29 June 2016	—	2,400,000	1.76	1.74
Employee	—	2,000,000	30 June 2006	30 June 2006 to 29 June 2016	—	2,000,000	1.76	1.74

Note 1: All the above Directors' interests in share options are personal and in long position.

Note 2: All of the above share options granted on 30 June 2006 can be exercised immediately upon acceptance of the offer by the grantee and there were no vesting conditions/period.

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EQUITY-SETTLED SHARE OPTION SCHEME *(Continued)*

The fair value of share options granted on 30 June 2006 was HK\$16,266,974 (approximately RMB16,745,000) which was calculated by using the Binomial option pricing model. The Group recognized the above fair value as expenses during the year. The model inputs were the share price at grant date of HK\$1.76, exercise price of HK\$1.76, expected volatility of 43.0%, expected dividend yield of 3.68%, contractual life of 10 years, and an annual risk-free interest rate of 4.84%. To allow for the effects of early exercise, it was assumed that the grantee would exercise the share options when the share price of the Company was twice the exercise price (the "Early Exercise Multiple"). The expected volatility was determined by using the annualized standard deviation of the historical share price of the Company since its listing on 2 March 2004 and other comparable listed companies for the last five years. To consider the expected life of expiration, the Company made reference to both the employee turnover rate and the early exercise multiple. The employee turnover rate is based on the historical turnover record of Directors and senior management of the Company. As the Company's share listed on the Stock Exchange in Hong Kong since 2004, the Company cannot solely rely on the historical employee turnover rate due to its short track record period. Alternatively, the Company determined the expected life of expiration by applying the Early Exercise Multiple.

As the Binomial option pricing model requires the input of highly subjective assumptions, including the volatility of share prices, changes in subjective input assumptions can materially affect the fair value estimate.

The accounting policy for equity-settled share options is stated in note 2.20 to the consolidated financial statements.

DIRECTORS' RIGHTS TO ACQUIRE SHARES OR DEBENTURES

Save as disclosed above, at no time during the year 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 spouses or children under 18 years of age, or were any such rights exercised by them; or were 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 spouses or children under 18 years of age to acquire such rights in any other body corporate.

CONTRACTS OF SIGNIFICANCE

Save as disclosed above and the transactions as disclosed in Note 35 to the consolidated financial statements, no controlling shareholder or any of its subsidiaries have any contract of significance with the Company or its subsidiary during the year.

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SUBSTANTIAL SHAREHOLDERS

At 31 December 2006, 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
Pioneer Iron & Steel Group Company Limited	817,519,151 (Note 1)	28.14%	Long
Smart Triumph	817,519,151 (Note 1)	28.14%	Long

Note 1: At 31 December 2006, Ms. Chen Ningning beneficially owned 100% of the issued capital of Pioneer Iron & Steel Group Company Limited which in turn owned 100% of the issued share capital of Smart Triumph. Smart Triumph owned 817,519,151 shares or 28.14% of the issued shares of the Company.

Save as disclosed above, at 31 December 2006, 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 as below and in note 35 to the consolidated financial statements.

The purchases of raw material by Foshan Jin Xi Jin Lan Cold Rolled Sheet Co., Ltd. ("Foshan Jinxi"), an indirect non-wholly owned subsidiary of the Company from Hebei Jinxi Iron and Steel Company Limited ("Jinxi Limited."), an indirect non-wholly owned subsidiary of the Company have constituted continuing connected transactions under the Listing Rules. The shareholders of the Company have approved the above continuing connected transactions and the related annual cap for a period of three years ending 31 December 2007 on 4 February 2005. During the year ended 31 December 2006, the purchase of raw material (excluding value-added tax) by Foshan Jinxi from Jinxi Limited amounted to approximately RMB105.2 million.

In the opinion of the independent non-executive Directors of the Company, the purchases of raw material by Foshan Jinxi from Jinxi Limited for the year ended 31 December 2006 were entered into:

- (i) in the ordinary and usual course of business of the Group;
- (ii) on normal commercial terms;
- (iii) in accordance with the relevant agreement governing such transactions on terms that are fair and reasonable and in the interests of the shareholders of the Company as a whole; and

DIRECTORS' REPORT

RELATED PARTY AND CONNECTED TRANSACTIONS *(Continued)*

- (iv) within the relevant annual cap amounts as approved by the shareholders of the Company on 4 February 2005.

The board of Directors confirms that the auditors of the Company have confirmed the matters stated in Rule 14A.38 of the Listing Rules in connection with the above continuing connected transactions.

On 12 December 2005, the Company announces that it and Foshan Jin Lan will issue guarantees to a PRC financial institution to secure the loan obligation of Foshan Jinxi on a several basis and in proportion to their equity interest. The guarantee will expire when the loan obligation and other relevant interest and expenses under the loan contract are repaid fully. The loan facility granted by the PRC financial institution is RMB150 million with a period of 3 years. The maximum liability under the guarantee of the Company will be RMB90 million and the related outstanding interest and expenses (if any). The guarantee was approved by the shareholders of the Company and was issued on 19 January 2006.

On 12 December 2005, the Company announces that Accordpower Investments Limited, a wholly-owned subsidiary of the Company, will provide shareholder's advances of US\$18.5 million to Foshan Jinxi. The non-interest bearing advances are US\$11.3 million while the interest bearing advances are US\$7.2 million. The interest rate of the interest bearing advances are based on 90% of the standard RMB loan interest rate of five years issued by the People's Bank of China. The duration of the advances will be 5 years. The shareholder's advances agreements were approved by the shareholders of the Company and signed on 19 January 2006.

Jinxi Limited has issued a guarantee dated April 2006 to a PRC bank to secure the master bank facility of RMB150 million granted to Foshan Jinxi by a PRC bank. The master bank facility's period is from 30 May 2006 to 30 May 2007. The maximum liability under the guarantee of Jinxi Limited will be RMB150 million plus the related outstanding interest and expenses (if any). The obligations of Jinxi Limited under the guarantee in respect of each individual facility granted under the master bank facility will expire two years after the expiry date of each individual facility being granted under the master bank facility. Foshan Jinxi will pay a guarantee fee of RMB900,000 for the year ended 30 May 2007 (plus any accrued interest), which is equivalent to 0.6% of the amount under the guarantee. Due to oversight and inadvertent misunderstanding of the Listing Rules by some of the management of the Group involved in the issuance of the guarantee, Jinxi Limited's entry into the guarantee and the provision of the guarantee was not reported to the Company. As a result, the failures by the Company to notify the Stock Exchange and announce Jinxi Limited's entry into the guarantee and the provisions of the guarantee and to seek shareholders of the Company's approval as required under Chapter 14A of the Listing Rules constitutes a breach of Rule 14A.63 of the Listing Rules.

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RELATED PARTY AND CONNECTED TRANSACTIONS *(Continued)*

Each of the Directors is aware and understands that each has undertaken to the Stock Exchange that in exercising each of their powers and duties as a director, each of them would comply to the best of his or her ability (and to procure the Company to comply) with the Listing Rules. However, in view of the facts surrounding the provision of the guarantee and in particular, the fact the Directors (other than the two executive Directors involved in issuing the guarantee, being Mr. Han and Mr. Shen) were not aware of Jinxi Ltd. entering into the guarantee, after discussion amongst the members of the Board, the Board considers that Mr. Han and Mr. Shen, as executive Directors of the Company and also more importantly as the directors and in respect of Mr. Shen only, deputy general manager of Jinxi Ltd. are mainly accountable for this breach of the Listing Rules.

Mr. Zhou Weijie, is a director of Foshan Jinxi and Foshan Jin Lan Aluminium Co., Ltd. (a company which is controlled by Mr. Zhou Weijie) has 40% of the equity interest in Foshan Jinxi. Therefore, Foshan Jinxi is a connected person of the Group in accordance with the Listing Rules.

Save as disclosed above and in Note 36 (i) to the consolidated financial statements, there were no other transactions required to be disclosed as non-exempt connected transactions in accordance with the Listing Rules.

SUFFICIENCY OF PUBLIC FLOAT

The Company has maintained a sufficient public float throughout the year ended 31 December 2006.

PURCHASE, SALES OR REDEMPTION OF LISTED SECURITIES OF THE COMPANY

Neither the Company, nor any of its subsidiaries has purchased, sold or redeemed any of the Company's listed securities during the years ended 31 December 2006 and 2005.

SUBSEQUENT EVENTS

Details of the significant post balance sheet events are set out in Note 36 to the consolidated financial statements.

AUDITORS

PricewaterhouseCoopers retired 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, 3 April 2007