

## Chairman's Statement

Dear Shareholders,

On behalf of the Board of Directors, I hereby present to you the operating results of the Group for 2006.

During 2006, the Group realised a sales income of RMB34,320 million, representing an increase of 7% over the previous year. In accordance with PRC Accounting Standards, net profit amounted to RMB2,277 million, representing a decrease of 20% over the previous year. Earnings per share stood at RMB0.353, representing a decrease of 20% over the previous year. In accordance with Hong Kong Accounting Standards, net profit for 2006 amounted to RMB2,395 million, down 18% from the previous year. Earnings per share stood at RMB0.371, representing a decrease of 18% over the previous year.



Looking back on 2006, global economic growth was relatively rapid and the Euro Zone economy grew faster than expected. Global production of iron and steel grew steadily to 1,240,000,000 tonnes, an increase of 8.8% as compared to the previous year. Demand for steel products remained robust. In 2006, China's national economy continued to maintain a steady and fast pace of growth, reporting a GDP growth of 10.7% over the previous year, while fixed asset investments of the society at-large rose 24.0% as compared to the previous year. The nationwide steel output amounted to 419,000,000 tonnes, representing an 18.48% increase over the previous year. In 2006, prices in the domestic steel product market rose initially but dropped later, with the consolidated price index for steel products rising from 94.18 as at the end of 2005 to 114.85 by the end of June, then dropping back to 105.15 by the end of December. The 2006 average prices of steel products were below those in 2005, with medium thick boards, hot-rolled thin plates, cold-rolled thin plates and galvanised plates reporting larger price declines of 14.5%, 12.9%, 18.9% and 15.8% respectively. The price decreases in wires and corrugated steel were less significant, being 6.2% and 9.1% respectively. (Source: National Bureau of Statistics, China Iron and Steel Association)

During the reporting period, the Group implemented the low-cost strategy and the brand strategy to strive for enhancement in economic effectiveness. By optimising resource deployment, technological and economic indicators reported improvements and progress was made in energy saving and consumption reduction, thereby demonstrating cost management efficiency. By actively pursuing research-production-sales integration, the Company developed and produced approximately 870,000 tonnes of new products including hot-rolled H-shaped steel for vehicle chassis, electrical steel and cold-forged steel. 990,000 tonnes of steel products were exported, of which 430,000 tonnes were H-shaped steel. In 2006, the Group produced 9,440,000 tonnes of pig iron, 10,910,000 tonnes of crude steel and 10,240,000 tonnes of steel products (among which the Company produced 8,910,000 tonnes of pig iron, 10,240,000 tonnes of crude steel and 9,540,000 tonnes of steel products), representing increases of 12.8%, 13.2% and 15.2%, respectively, over the previous year.

During 2006, the Company made new progress in infrastructure construction and technological enhancements. Difficulties such as tight schedules, demanding technological requirements and highly difficult construction works were overcome in the construction of the new area, with the construction of the Thin Plate Line with a production capacity of 5,000,000 tonnes meeting the stage targets. Meanwhile, the Company commenced in full force the preparation for the commencement of operation of the new area, including the absorption of and adjustment with new techniques and technologies, the drafting of position-based operating guidelines, staff training and product positioning. The commencement schedule of the new area's key projects and the planning for the transition from the original systems to the new systems were completed in a sophisticated manner,

laying a solid foundation for the new area to realise smooth commencement and early achievement of output. Meanwhile, the capacity enhancement project of the train wheel heating, processing and testing system was completed and commenced operation, while the capacity enhancement of the train wheel rolling system was under preparation. The no.6 thermal power gas-fired furnace project was completed as scheduled and the cold-rolled silicon steel line progressed as scheduled.

In March 2006, the Company successfully implemented the State Share Reform Proposal. In November 2006, the Company successfully issued and listed the 5-year Bonds with Warrants in a principal amount of RMB5,500 million. The issuance raised long-term funding for the Company and saved financing costs.

In May 2006, with reference to the Company's strategic development, the Company restructured the core iron and steel businesses of the original Hefei Iron & Steel Group through equity investments upon approval of the Board of Directors. Details of the transaction are: the Company and Hefei Investment Holding Company Limited ("Hefei Investment Holding") jointly invested and established Ma Steel (Hefei) Iron & Steel Co. Ltd. ("MS (Hefei)"), with a registered capital of RMB500 million. The Company contributed RMB355 million for 71% equity interests, while Hefei Investment Holding contributed RMB115 million in cash and RMB30 million of restructured net assets related to the iron and steel operations acquired from the original Hefei Iron & Steel Group, for 29% equity interests. Upon the restructuring, the operation of MS (Hefei) has been gradually improving through strengthened management and the support of the parent company's purchase and sales platforms. From May to December, its outputs of pig iron, crude steel and steel products were 530,000 tonnes, 670,000 tonnes and 690,000 tonnes respectively, realising approximately RMB1,823 million in income from principal operating activities and a net profit of approximately RMB20.12 million. In addition, with reference to the production operation needs, the Company also invested in and established Ma Steel (Hefei) Processing and Distribution Co., Ltd., acquired 71% equity interests in Burwill Coil Centre (Yangzhou) Company Limited and renamed the latter to Ma Steel (Yangzhou) Processing and Distribution Co., Ltd.

Looking ahead into 2007, authoritative international institutions such as the International Monetary Fund and the World Bank estimated that the global economic growth is expected to slow down after maintaining a rapid growth for four consecutive years. The growth of global steel product consumption will remain at a relatively high level, but the growth in steel product demand will decline. By following the objective of "Attaining Sound and Rapid Growth", China's national economy will continue to maintain a steady and relatively fast development momentum. The State will balance the linkage between the speed, quality and efficiency of economic development and will coordinate the linkage between consumption, investments and exports, so as to enhance the levels of integrated resources utilisation and environmental protection. It is estimated that the intensity of domestic steel product consumption will weaken in 2007, while the demand in the steel product market will maintain certain growth.

The Group's 2007 operating targets are: producing 13,160,000 tonnes of pig iron, 14,520,000 tonnes of crude steel and 13,440,000 tonnes of steel products (among which the Company plans to produce 11,870,000 tonnes of pig iron, 13,000,000 tonnes of crude steel and 11,940,000 tonnes of steel products).

To achieve the above operating targets, the Group will adopt the following major measures, in line with the strategies of "Pushing forward standardisation work; Accelerating the implementation of the low-cost strategy and the brand strategy":

## Chairman's Statement (Continued)

- Pushing forward standardisation work

The Company will continue to make the promotion of standardised operation as a breakthrough target, so as to integrate the standardisation concept and management mode into all areas of work, thereby building a standardised corporate working system as soon as possible, which will be of great help to accelerating the implementation of the low-cost strategy and the brand strategy.

- Accelerating the implementation of the low-cost strategy and the brand strategy

On the premise of scientifically balancing resources to realise an efficient integration of the new area and the old system, the Company will strive for stable, balanced and efficient production. The Company will endeavour to enhance the quality of products, to strengthen new product development and to increase the output of high added-value products, so as to increase the profitability per tonne of steel production. The effort on cost reduction and efficiency enhancement will be escalated, with a systematic cost-reduction concept to be established while efforts will be devoted to exercising the whole process of cost control from fuel and raw material purchase, storage, to production and sales, whereas management innovations and technological innovations regarding cost reduction will be focused. The Company will elevate the breadth and depth of the cost reduction and efficiency enhancement efforts. Meanwhile, marketing and sales will be strengthened, with the efforts on marketing and sales channels, pricing strategies, product promotion and development of information-based sales and marketing to be further enhanced. The Company will consolidate a cohesive steel supply chain and develop a service-oriented marketing and sales system. Based on the sales features of the new area's high-end plate products, it will also develop a strategic client base and effectively carry out product promotions and whole-process services, with the support of the processing and distribution centres.

- Accelerating project constructions

Based on the overall requirement of "high starting level, low investment, fast in speed, good quality", the Company will closely focus on significant commencement targets such as those for coke furnaces, blast furnaces, converters, hot roll, cold roll and galvanising lines, in order to effectively coordinate the linkage between project construction, facility inspection and testing and trial operation, thereby completing the construction of the new area as scheduled. Meanwhile, the Company will effectively conduct product market research, prepare production information, carry out position skill training, and absorb and adjust to newly installed technologies, as well as devoting itself to commencement preparations such as the drafting and optimisation of various plans, so as to create the conditions facilitating a safe, stable and smooth commencement of production in the new area.

- Accelerating the development of a recyclable economy

Based on the principle of "reduction, reuse and recycling", the Company will plan and consider recyclable-economy projects with preferential arrangement and accelerated construction for such projects. Accordingly, the Company will strive for achieving the benign cycle of enhanced resource utilisation, reduced consumption of fuel and raw materials, improved environment and lowered costs. Meanwhile, the Company will actively promote clean production, analysing the production process based on the whole life cycle of a product and adopting new techniques and technologies, thereby making the production process concise, large-scale and continuous. Accordingly, the Company can reduce the usage of primary resources and maximise the utilisation of iron-imbued raw materials. The technical and energy structures will be rationalised, with the application of advanced energy-saving technologies to be

promoted and the outdated techniques and facilities to be phased out or renovated. Residue energy, electricity and heat will be sufficiently utilised, thereby substantially enhancing the efficiency of energy utilisation. Advanced water treatment techniques will be adopted to facilitate the reduction of water resource consumption and recycling of sewage, striving for a utilisation rate of recycled water exceeding 95% and reducing the fresh water consumption per tonne of steel production to less than 8 tonnes. The Company will also step up the mechanisation of the online slag treatment system and the development of applied technologies for advanced processing in the new area, as well as enhancing the comprehensive utilisation of solid wastes.



- Continuing the reforms and enhancing management

The Company will continue to instill the standardisation concept into all types of management work, so as to facilitate continuous enhancement in management quality. The lead operator system will be further enhanced, while the achievement of regional integration will be consolidated and expanded. The appraisal system under the economic accountability system and the performance assessment system will be improved, so as to provide effective guidance and leverage. "Integration of Three Standards", as well as the standard implementation and certification of the surveying management system, will be further pursued. Information system development will be accelerated, starting with the new area and expanding to the whole company.

- Maintaining a "people first" approach

The Company will actively cultivate a harmonious development environment to accumulate the wisdom and effort of the staff, so as to facilitate development through harmony and to achieve harmony through development. The human resource management information system will be enhanced and human resource deployment will be optimised, effectively utilising the existing talents of different types. A systematic human resource planning will be studied and formulated. A team of talented management, technical and operating staff will be cultivated and expanded, so as to provide human resources to support the implementation of the low-cost strategy and the brand strategy.

Finally, on behalf of the Board of Directors, I express my gratitude to all shareholders for their keen support to the Company over the past year. In the new year, the Board of Directors will endeavour to perform their duties diligently and faithfully, bringing better returns to shareholders.

**Gu Jianguo**

*Chairman*

17 April 2007

Maanshan City, Anhui Province, the PRC