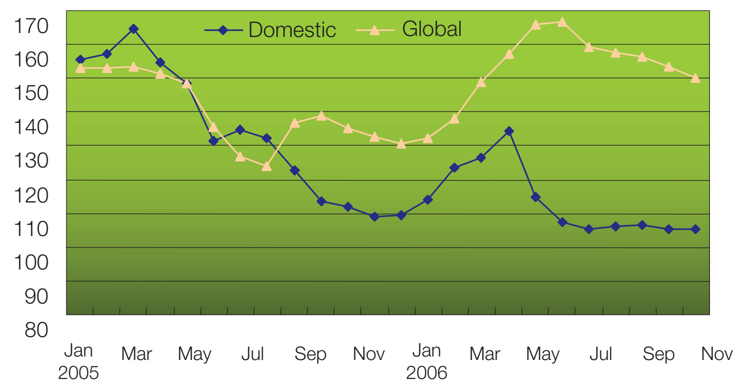
(1) Review of Operating environment

A. The Steel Product Market

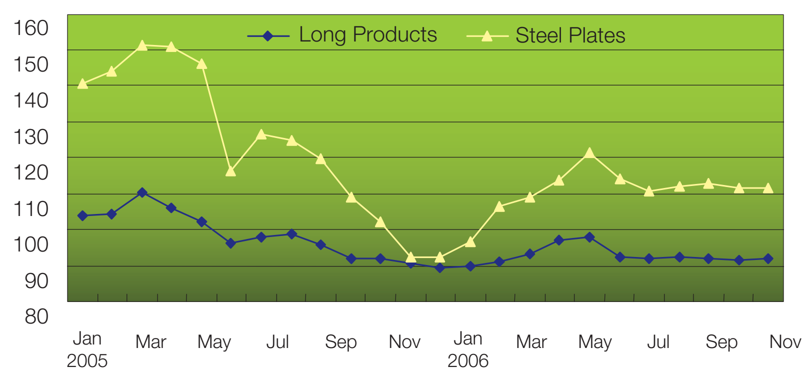
In 2006, demand was robust in the global steel market. Steel prices rose substantially and continued to hover at a relatively high level. China's national economy maintained a steady and relatively fast growth in 2006, with the demand for steel products increasing. Steel product prices embarked on a 4-month rebound starting from February. During 2006, the State continued to implement macroeconomic control measures to rein in economic development, with bank borrowing rates raised and export tax rebate rates for steel products reduced. In the second half, both fixed asset investments and industrial output of the society at-large saw a significant slowdown in growth, while the growth of domestic steel product demand also waned. Accordingly, domestic steel product prices dropped back substantially. The 2006 consolidated index for global steel products was ahead of the domestic index, with the former being 23.50 points higher as at the end of 2005 and 45.05 points higher by the end of 2006.

Consolidated Indices for Global and Domestic Steel Product Prices: 2006



Comparing major categories of domestic steel products, the price index for steel plates was 111.49 as at the end of 2006, up 20.6% from the end-2005 level of 92.42. The price index for long products was 91.77 as at the end of 2006, representing an increase of just 1.1% from the end-2005 level of 90.81.

Price Indices for Domestic Long Products and Steel Plates: 2006



Imports and exports of Chinese steel products underwent a historic change in 2006. Imports decreased significantly and exports increased substantially, turning China from a major steel product importer to a major exporter. In 2006, China imported 18,510,000 tonnes of steel products, representing a 28.3% decrease from 2005. Steel product exports amounted to 43,010,000 tonnes, a 109.6% increase as compared to 2005. The balance shifted from a net import of 5,300,000 tonnes as in 2005 to a net export of 24,500,000 tonnes. (Note: Source from China Iron and Steel Association)

B. The Raw Material Supply Market

In 2006, the FOB price of the Company's iron ore imported from overseas increased by 19% as compared to the previous year. Prices for externally purchased electricity increased by 3.0% over the previous year, while the prices of coal, coke, externally procured pig iron, scrap steel and alloys reported decreases.

(2) Basic strategies and major work

In 2006, long products accounted for 64.3% of the Company's steel products while steel plates accounted for 33.4%. With the gross profit of steel plates higher than that of long products in 2006, the product structure affected the profitability of the Company's principal products. Approximately 75% of the iron ore used by the Company was imported overseas, therefore the substantial surge in imported ore prices exerted a massive pressure on the Company's costs. Facing the changes in the domestic and foreign steel product markets and the pressure on costs, the Company adopted the low-cost strategy and the brand strategy, as well as actively implementing various measures to reduce costs and enhance efficiency. The major work was as follows:

- **Continued with the low-cost strategy, increasing the output of products with higher added-value and better gross margins**

  The Company stood by the principle of "sales determining production". By overcoming the restraint of the production bottleneck and optimising the deployment of resources such as iron ore, pig iron and scrap steel, further production capacity was released, thereby alleviating the pressure brought by rising prices of iron ore and electricity and improving the economic and technical indicators. In 2006, the Company's crude steel output broke the 10,000,000-tonne threshold, with increased output for steel plates, small H-shaped steel, train wheels and wheel rims, which offered higher added-value and better gross margins. Among these, the output for train wheels and wheel rims increased by 21.45% year-on-year. The Company's gross coking ratio per tonne of iron reported a decrease equivalent to 22 kilogrammes of standard coal, while the overall energy consumption per tonne of steel reported a decrease equivalent to 14 kilogrammes of standard coal. Fresh water consumption per tonne of steel decreased to 8.61 tonnes, while the ratio of self-supplied electricity rose to 43.1%.

- **Continued with the brand strategy to closely knit technological innovations with brand building, thereby expanding branding effectiveness**

  In light of the tough condition that the number of domestic H-shaped steel producers increased and competition in the product market intensified, the Company capitalised on its advantages in H-shaped steel production and technology, actively pursuing research-production-sales integration. The Company developed the hot-rolled H-shaped steel for automobile chassis accordingly, making itself the first domestic enterprise developing and commencing trial production of hot-rolled H-shaped steel for automobile chassis. Meanwhile, the achievements of "Development and Applied Technology Study on Hot-Rolled H-shaped Steel Products" jointly conducted by the Company and other units was awarded the 2006 National Award for Science and Technology Progress (Second

Class). H-shaped steel products were certified under the Japanese Industrial Standards ("JIS"), while hot-rolled corrugated steel wires passed the on-site certification of the UK Certification Authority for Reinforcing Steels (CARES). Cold-rolled thin plates (including galvanised plates) and hot-rolled wire rods were named State Inspection-free Products. In addition, the Company compiled the "Ma Steel Outline for Technological Innovation Planning in the Eleventh Five-year Plan". During the year, the Company developed and produced approximately 870,000 tonnes of new products including electrical steel, plates for automobiles and cold-forged steel.

- **Endeavoured to implement structural adjustments and accelerated the construction of key projects**

  The new area's construction work completed successfully the yearly stage construction targets of the pre-metallurgy system, the steel rolling system, and so forth. The capacity enhancement project of the train wheel heating, processing and testing system, the enhancement of the medium-sized plate line and the no.6 thermal power gas-fired furnace project were completed on schedule, while the cold-rolled silicon steel line project progressed as scheduled.

- **Meeting market needs by pushing forward external investments and expanding extended processing operations**

  In 2006, the Company restructured the principal iron and steel operations of the original Hefei Iron & Steel Group through equity investments with controlling interests. Meanwhile, with reference to the status of steel product consumption, the Company established two steel product processing and distribution centres in Hefei and Yangzhou, both key regional markets for automobiles and home electrical appliances, after setting up the steel product processing and distribution centres in Guangzhou, Wuhu and Jinhua. Accordingly, the Company has successfully completed sales preparation before the commencement of the Company's 5,000,000-tonne thin plates production project in the new area in 2007.

  In 2006, the Company made the following external investments with its internal funding:

Company name	Principal activities	Equity interest held (%)	Investment amount (in RMB million)
Ma Steel (Hefei) Iron & Steel Co. Ltd.	Principally engaged in metallurgy and extended processing of ferrous metals and sale of resulting products and by-products; production and sale of coke, coke chemical products and energy, extended processing of iron and steel products, production and sale of metallic products	71	355
Ma Steel (Hefei) Processing and` Distribution Co., Ltd.	Principally engaged in production, processing and sale of cold and hot steel plates for various industries such as automobile and mechanical engineering of home electrical appliances, as well as steel products for construction structures.	Direct interest: 61 Indirect interest: 28	73.2
Ma Steel (Yangzhou) Processing and Distribution Co., Ltd.	Principally engaged in production, processing and sale of various types of steel plates, steel wires and steel sections and provision of storage, transportation and after-sales services of products.	71	61.651

(3) Results of the Group's principal operating activities for the reporting period prepared under PRC Accounting Standards

- Analysis of income from principal operating activities by segment and by product:

  The iron and steel segment accounted for 95.75% of the Group's income from principal operating activities. The iron and steel segment also accounted for 87.56% of the Group's profit from principal operating activities.

Unit: RMB million

Business segment	Income from principal operating activities	Cost of sales from principal operating activities	Gross profit margin (%)	Increase/ (decrease) of principal operating income compared to the previous year (%)	Increase/ (decrease) of cost of sales from principal operating activities compared to the previous year (%)	Increase/ (decrease) of gross profit margin compared to the previous year (%)
Iron and steel	32,862	29,018	11.70	7.31	10.50	Down 2.54 pct pts
Product segment						
Steel plate	11,400	10,154	10.93	(3.86)	2.17	Down 5.26 pct pts
Section steel	8,058	7,301	9.39	6.71	16.76	Down 7.80 pct pts
Wire rods	10,595	9,771	7.78	15.16	14.35	Up 0.66 pct pts
Train wheels and wheel rims	2,262	1,303	42.40	47.46	16.55	Up 15.28 pct pts

- Geographical analysis of the Group's income from principal operating activities:

Unit: RMB million

Region	Percentage (%)	Income from principal operating activities	Increase/(decrease) of income from principal operating activities compared to the previous year (%)
Anhui	36	12,272	155
Jiangsu	15	5,141	(41)
Shanghai	13	4,355	(27)
Zhejiang	7	2,689	(24)
Guangdong	7	2,402	38
Other PRC regions	11	3,615	(32)
Exports	11	3,845	96

- During the reporting period, the Group's gross profit margin of principal operating activities was 12.79%, a decrease of 2.14 percentage points as compared to the corresponding period of the previous year. This was mainly attributable to the year-on-year fall of the selling prices of the Company's steel products.

(4) Assets and liabilities of the Group for the reporting period prepared under PRC Accounting Standards

- Assets

  During the reporting period, there were no material differences on the proportions of bills receivable, trade receivables, other receivables, inventories and long-term equity investments out of total assets when compared to the previous year. The amount of net fixed assets accounted for 34.30% of total assets, a decrease of 13 percentage points over the previous year, which was mainly due to an increase in the Company's total assets during the reporting period. Construction in progress accounted for 34.39% of total assets, an increase of 22.23 percentage points over the previous year, mainly owing to the Company's implementation of the "Eleventh Five-year Plan" to fully proceed with the construction of the 5,000,000-tonne thin plates production project in the new area during the reporting period.

- Liabilities

  During the reporting period, the ratios of short-term loans, bills payable, accounts payable, deposits received and other payables in relation to total assets had no material changes as compared to the previous year. Long-term loans accounted for 28.65% of total assets, an increase of 6.6 percentage points from the previous year, which was mainly due to an increase in long-term bank borrowings resulting from the Company's implementation of the "Eleventh Five-year Plan".

  The Company issued RMB5,500 million of Bonds with Warrants on 13 November 2006 and redeemed the RMB2,000 million short-term commercial papers on 28 December 2006 upon maturity.

(5) Expenses and income tax of the Group for the reporting period prepared under PRC Accounting Standards

During the reporting period, selling expenses increased by 9.57% over the previous year, which was mainly due to increases in sales volume of steel products, transportation costs and loading and unloading costs. Administrative expenses increased by 3.73% over the previous year, which was mainly due to increases in salaries and other salary-type payments. Financial expenses were increased by 63.63% over the previous year, which was mainly due to a decrease in foreign exchange gains and an increase in foreign exchange loss in the reporting period as compared to the previous year. Income tax decreased by 2.66% over the previous year, which was mainly due to a decrease in the Company's profit.

(6) Operating results

As at the end of 2006, in accordance with PRC Accounting Standards, the Group's principal operating income rose 7% from the corresponding period of the previous year, which was mainly due to an increase in sales volume of the Company's steel products. Profit from principal operating activities dropped 9% from the corresponding period of the previous year, which was mainly due to the sales price decreases for certain types of the Company's steel products as compared to the previous year. Net profit dropped 20% from the corresponding period of the previous year, which was mainly due to a decrease in profit from principal operating activities.

(7) Analysis of the Group's cash flows for the reporting period prepared under PRC Accounting Standards

In 2006, the Group realised a net profit of RMB2,277 million, a difference of RMB3,006 million when compared to the net increase of cash flow of RMB5,283 million generated from operating activities, which was mainly due to depreciation charges for fixed assets. The amount of net increase in cash flow generated from operating activities decreased by RMB888 million as compared to the corresponding period of the previous year, which was mainly due to the sales price decreases for certain types of the Company's steel products as compared to the corresponding period of the previous year. The amount of net cash outflow from investing activities increased by RMB5,493 million as compared to the corresponding period of the previous year, which was mainly due to acquisition and construction of fixed assets and external investments. The amount of net cash inflow from financing activities increased by RMB5,950 million as compared to the corresponding period of the previous year, which was mainly due to the securing of bank loans and the issuance of the bonds with warrants.

(8) Major suppliers and customers

In 2006, the Group's purchase from the top five suppliers totalled at RMB7,812 million, accounting for 28% of the Group's total purchase amount for the year. The Group's sale to the top five customers totalled at RMB4,203 million, representing 12% of the total sales revenue of the Group for the year. Of the above-mentioned major suppliers, Holding is a controlling shareholder of the Company. Other than that, in 2006, none of the directors, supervisors, their connected parties or other shareholders (to the knowledge of the Board of Directors holding 5% or more of the Company's shares) held any beneficial interest in the Group's five largest suppliers or customers.

(9) The operations and results of the Group's major controlling subsidiaries and invested entities

- Ma Steel (Hefei) Iron & Steel Co. Ltd. has a registered capital of RMB500 million, in which the Company holds a direct stake of 71%. It is mainly engaged in metallurgy and extended processing of ferrous metals and sale of resulting products and by-products; production and sale of coke and coke chemical products and energy; extended processing of iron and steel products; and production and sale of metallic products. Net profit for the reporting period amounted to RMB20 million. As at the end of the reporting period, total assets amounted to RMB1,160 million.

- Ma Steel International Trade and Economics Corporation, a wholly-owned subsidiary with a registered capital of RMB50 million, is mainly engaged in the import of machinery and raw materials and export of steel products. Net profit for the reporting period amounted to RMB13 million. As at the end of the reporting period, total assets amounted to RMB1,564 million.

- Design & Research Institute of Maanshan Iron & Steel Company Limited has a registered capital of RMB50 million, in which the Company holds direct and indirect stakes of 58.96% and 7.86%, respectively. It is mainly engaged in metallurgical, construction and planning and design of environmental protection projects. Net profit for the reporting period amounted to RMB42 million. As at the end of the reporting period, total assets amounted to RMB223 million.

- Anhui Masteel K. Wah New Building Materials Co., Ltd. has a registered capital of US$4.29 million, in which the Company holds a direct stakes of 70%. It is mainly engaged in the production, sale and transportation of slag comprehensive utilisation products and the provision of related technological consultation services. Net profit for the reporting period was RMB7 million. As at the end of the reporting period, total assets amounted to RMB98 million.

- Ma Steel (Wuhu) Processing and Distribution Co., Ltd. has a registered capital of RMB35 million, in which the Company holds direct and indirect stake of 70% and 30%, respectively. It is mainly engaged in the processing and sale of metallic products, processing of automobile spare parts and sale of construction materials and chemical products. Net profit for the reporting period amounted to RMB17 million. As at the end of the reporting period, total assets amounted to RMB709 million.

- Ma Steel (Guangzhou) Processing and Distribution Co., Ltd. has a registered capital of RMB120 million, in which the Company holds a direct stake of 66.67%. It is mainly engaged in the production, processing and sale of steel products, as well as provision of storage, transportation and after-sales services. Net profit for the reporting period amounted to RMB35 million. As at the end of the reporting period, total assets amounted to RMB889 million.

- Anhui Masteel Holly Industries Co. Ltd. (安徽馬鋼和菱實業有限公司) has a registered capital of RMB30 million, in which the Company holds a direct stake of 71%. It is mainly engaged in the production, sale and agency of steel products and other product packaging materials and provision of on-site packaging services. Net profit for the reporting period amounted to RMB79 million. As at the end of the reporting period, total assets amounted to RMB210 million.

- Maanshan Iron and Steel (Australia) Proprietary Limited, a wholly-owned subsidiary, has a registered capital of AU$21.7379 million. It is mainly engaged in investment and trading. Net profit for the reporting period amounted to RMB28 million. As at the end of the reporting period, total assets amounted to RMB183 million.

- Ma Steel (Jinhua) Processing and Distribution Co., Ltd. has a registered capital of RMB120 million, in which the Company holds a direct stake of 75%. It is mainly engaged in the production, processing and sale of steel plates, wire rods and section steel, as well as provision of storage and after-sales services. Net profit for the reporting period amounted to RMB8 million. As at the end of the reporting period, total assets amounted to RMB408 million.

- 馬鞍山港口(集團)有限責任公司 has a registered capital of RMB250 million, in which the Company holds a direct stake of 45%. It is mainly engaged in stevedoring of materials at the ports, freight agency, ocean-land cargo transit and storage services. Net profit for the reporting period amounted to RMB14 million. As at the end of the reporting period, total assets amounted to RMB687 million.

- Maanshan BOC-Ma Steel Gases Company Limited has a registered capital of RMB468 million, in which the Company holds a direct stake of 50%. It is mainly engaged in the production and sales of gas products in gaseous or liquid form, as well as the preparation of other industrial gas product projects. As at the end of the reporting period, total assets amounted to RMB743 million and the Company had yet to commence operation.

(10) Fundraising proceeds

In 2006, the net proceeds from the Company's issuance of bonds with warrants, excluding issuing fees, amounted to approximately RMB5,355.65 million. Upon securing of the proceeds, the Company followed the stipulations under the "Management System for Specified Depositing and Utilisation of Fundraising Proceeds of Maanshan Iron & Steel Company Limited" to strictly enforce the specified account depositing system for fundraising proceeds, with the proceeds solely used to invest in the 5,000,000-tonne cold and hot thin plates production project as undertaken in the fundraising prospectus. As at the end of the reporting period, a total of approximately RMB3,846.35 million in fundraising proceeds had been used, with the balance of fundraising proceeds amounting to approximately RMB1,509.30 million to be further used on the 5,000,000-tonne thin plates production project in 2007.

- Undertaken investment projects funded by fundraising proceeds (RMB million):

Undertaken project	Planned investment amount	Any changes to the project	Actual investment in the project	Revenue generated	Meeting planned progress or not	Meeting planned progress or not
5,000,000-tonne cold and hot thin plates production project	5,355.65	No	3,846.35	Not applicable	Yes	Not applicable
Total	5,355.65	–	3,846.35		–	–

The 5,000,000-tonne cold and hot thin plates production project comprises mainly the Integrated Raw Materials Plot, the Iron-making System, the Steel-making System, the Hot-rolled Broad Belt System, the Pickled Cold Wire and Hot Galvanising Line and the Power Generating Plant Using Integrated Resources. The Iron-making System consists of two 3,600m^3 blast furnaces, with an aggregate designated annual production capacity of 5,670,000 tonnes; the Steel-making System consists of two 300-tonne converters, with an aggregate designated annual production capacity of 5,870,000 tonnes. The Hot-rolled Broad Belt System consists of a 2,250mm hot rolling production line with a designated annual production capacity of 5,500,000 tonnes. The Pickled Cold Wire and Hot Galvanising Line consists of a 2,230mm pickled cold wire production line and two hot galvanising production lines, with the former having a designated annual capacity of 2,100,000 tonnes and the latter having a designated annual capacity of 800,000 tonnes.

(11) Project constructions

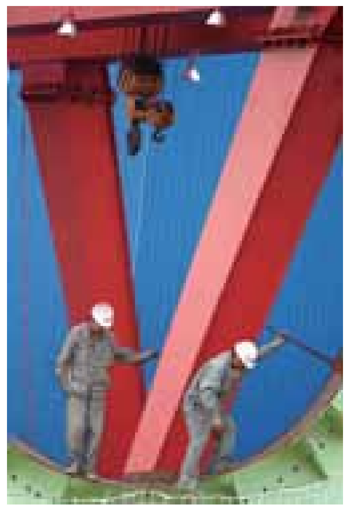
In 2006, the Group's expenses on projects in construction amounted to RMB16,163 million, representing a 200% increase over the previous year. Apart from the aforementioned 5,000,000-tonne cold and hot thin plates production project, the amount was also spent on the following projects:

- Investment projects financed by other than fundraising proceeds (RMB million):

Project name	Total investment	Construction progress
The Capacity Enhancement of Train Wheel Rolling System	320	Commenced production
The Cold-rolled Silicon Steel Line	1,080	Entering facility installation stage

(12) Financial position and exchange risks

For the year ended 31 December 2006, the total amount of loans borrowed by the Group was RMB16,522 million, including loans for working capital of RMB5,523 million and construction loans of RMB10,999 million. Except for foreign currency loans amounting to US$105 million and 3 million Euro, all other loans were denominated in RMB. Except for a foreign currency loan amounting to US$104 million which carried interests at LIBOR plus a fixed percentage and a RMB7,027 million loan which carried interests at a 10% discount from the central bank benchmark rate, all other loans carried interests calculated at fixed interest rates. Movements of the Group's bank loans followed the developments in production and construction projects. No overdue payments have been recorded so far. On 28 December 2006, the Company repaid the first tranche of short-term commercial papers of RMB2,000 million.



As at 31 December 2006, in accordance with PRC Accounting Standards, the Group's gearing ratio (total liabilities/total assets) stood at 62.74%. Under the Hong Kong Accounting Standards, the Group's gearing ratio (total liabilities/total assets) stood at 62.04%.

Other than internal resources and the proceeds from the Bonds with Warrants issue, all capital requirements for the Group's Eleventh Five-year Plan were financed through bank loans. As at the end of the reporting period, bank commitments to provide banking facilities to the Group amounted to approximately RMB29,209 million.

As at 31 December 2006, the Group's cash and balances with financial institutions amounted to RMB4,161 million. Bills receivable amounted to RMB681 million (of which bank bills receivable due within three months amounted to RMB443 million). Deposits received for the coming month constituted a substantial part of the cash and balances with financial institutions and bank acceptance bills.

The Group's import of raw materials was settled in US dollar, while import of equipment and spare parts was settled in Euro or Japanese Yen, and export of products was settled in US dollar. Given that the US dollar to RMB exchange rate continued to depreciate, an exchange gain was resulted from the Company's US dollar-denominated debts. Moreover, since the amount of payments denominated in US dollar on imported iron ore is larger than that of income from export, the appreciation of RMB exchange rate is favourable to the Company. During the reporting period, the exchange rates of Euro and Japanese Yen have fallen compared to the time when the Company signed contracts for European and Japanese equipment purchases. Accordingly, the capital costs for actual payments in Euro and Japanese Yen were lower than the original estimates. The Company has been maintaining contacts with various banks to obtain information of emerging financial products from banks, so as to select products which are suitable for the Company to help the Company avoid possible exchange rate risks.

(13) Impact of the implementation of the New Accounting Standards on the Company's Financial Position and Operating Results

The Ministry of Finance officially published the Accounting Standards for Enterprises on 15 February 2006 and ordered that such standards be implemented among listed companies with effect from 1 January 2007. Upon implementation of the Accounting Standards for Enterprises, the following changes will take place on the Company's accounting policies:

A. Employee Welfare Fund

As stipulated by the new Accounting Standards for Enterprises (the "New Accounting Standards"), "employee welfare fund" is an item without any definite contribution base or contribution ratio. The Company shall determine its policy on employee welfare fund contribution with reference to historical experience and data, as well as its actual situation.

According to the above stipulations and considering the Company's actual utilisation of employee welfare fund throughout the years, starting from 2007, the Company shall compile an annual utilisation plan for the welfare fund each year and accrue expenses accordingly on the actual welfare fund contributions, while the full balance of un-utilised welfare fund by the end of the year shall be written back to the profit-and-loss account of the year. In case the year's actual welfare fund expenses exceed the year's contribution amount, the difference shall be accordingly stated as a cost for the year, with tax adjustments to be made for any contribution portion in excess of the contribution percentage stipulated by the taxation laws.

B. Investment Properties

As stipulated by the New Accounting Standards, the ongoing accounting method for investment properties can be the cost model or the fair value model. An enterprise may adopt only one model for the ongoing accounting of all investment properties, and the accounting model may not be changed at will once confirmed. The New Accounting Standards also specifically stipulate that in case the accounting model for investment properties is to be changed, a switch from the cost model to the fair value model shall be treated as a change in accounting policy, while investment properties adopting the fair value model cannot switch from the fair value model to the cost model.

As at present, the Company's investment properties comprise mainly land use rights (respectively leased to subsidiaries and associates). Considering the fact that the leased land use rights as at present are all lands within the Company's plants, it is difficult to determine their fair values. Accordingly, the Company will continue to adopt the cost model to determine the initial book value and conduct ongoing accounting for the investment properties.

C. Financial Instruments

According to the New Accounting Standards' stipulations on financial instruments, and considering the actual situation of the Company, the Company is currently involved in the following three types of financial instruments:

a. Held-to-maturity investments, i.e. the 皖能電力 bonds held by the Company;

b. Compound financial instruments, i.e. the bonds with warrants issued by the Company;

c. Available-for-sale investments (H share disclosure category), i.e. the Company's investments in Shanghai Chlor-Alkali Chemical Company Limited, 河南龍宇能源股份有限公司, and so forth; A shares are disclosed under the item "Long-term Equity Investments - Other Investments".

D. Prudent and Appropriate Adoption of the Fair Value Accounting Model

According to the requirements of the China Securities Regulatory Commission's document Zheng Jian Fa [2006] No.136, when adopting the fair value model, pursuant to the New Accounting Standards, for the accounting of major asset and liability items in the financial statements, the Company management shall take into account various influencing factors such as active market transactions, in order to give scientific and reasonable assessments on whether fair values can be obtained in an ongoing and reliable manner. The Board of Directors shall make decisions on the basis of sufficient discussion. Taking into account the current state of the Company's assets and liabilities, the Company has adopted the fair value model to account for items where the fair value accounting model is applicable, such as the Bonds with Warrants. The fair value accounting model led to a retrospective increase of RMB714 million in shareholders' equity for the Company as at 1 January 2007, as well as increases in financial costs for the next five accounting years.

E. Capitalisation of Borrowing Costs

As stipulated by the New Accounting Standards, borrowing costs that may be capitalised are no more limited to those generated by specific borrowings (meaning specific borrowings obtained for a specific project under construction, such as the borrowings for the Integrated Raw Materials Plot of the new area), whereas ordinary borrowings (meaning non-specific borrowings not ascribed to a specific project) such as those used for acquiring, building or producing assets that meet the capitalisation requirements shall be capitalised as well provided certain requirements are met. According to this stipulation, the Company is amending the accounting method for borrowing cost capitalisation to meet the requirements of the New Accounting Standards and facilitate the adoption of a uniform principle and method for the recognition and accounting of borrowing cost capitalisation. In accordance with the requirements of the China Securities Regulatory Commission's document Zheng Jian Fa [2006] No.136, the Board of the Company shall consider and pass resolutions for borrowing cost capitalisation involving ordinary borrowings. As at present, the Company is not involved in any cost capitalisation of ordinary borrowings and in case such matters take place in future, such matters will be reviewed and decided by the Board of Directors in accordance with the requirements of the China Securities Regulatory Commission.

F. Others

As stipulated by the New Accounting Standards, the Company's accounting policies have also undergone the following changes:

a. The accounting of income tax has been changed from the tax payable method to the liability method;

b. As for investments in subsidiaries, the equity method, instead of the cost method, is now adopted for the parent company's individual financial statements;

c. Asset-related government subsidies are no more transferred to the capital reserves upon completion of construction projects, but instead recognised as deferred income and amortised on average over the useful lives of the relevant assets and released to the income statement of the current period;

d. The scope of staff remuneration of the Company is expanded. Not only does it include staff salaries, bonuses, allowances and subsidies, but also staff welfare payments, social insurance premiums including medical insurance premiums, pension insurance premiums, unemployment insurance premiums, industrial injury insurance premiums, and childbirth insurance premiums, housing reserve funds, labour union expenses and staff education expenses, non-monetary welfare, compensation to staff for termination of employment relationships, other expenses related to services provided by the staff, and so forth;

(E) The adoption of the effective interest method, with reference to amortised cost accounting, to account for held-to-maturity investments and borrowings.

Due to the changes in accounting policies, save as the aforementioned Bonds with Warrants, other accounting policy changes will have no material impact on the financial position and operating results of the Company. Meanwhile, the Company is currently conducting further assessments on the impact of the New Accounting Standards on the Company's operating results and financial position. After prudently considering and taking reference of the Ministry of Finance's further elaboration, the Company may make changes to the accounting policies or material recognitions, which may affect the amount changes.

(14) Changes in the production and operating environment in 2007 and coping strategies

This year, the State will execute the guidelines for a good and fast economic development to accomplish the objective of a GDP growth of around 8%. To accomplish the objective, prudent fiscal policies and monetary policies will be maintained, while continuing the direction of expanding domestic demand. Appropriate growth in fixed asset investments will be maintained, with important infrastructure developments such as large-scale water conservancy projects, energy bases, railway trunks and major national highway trunks to be accelerated, while upkeeping a continued healthy development of the property industry is also an aim.

In the "Government Work Report", Premier Wen Jia Bao of the State Council stated the determination to phase out obsolete production capacity. During the period of the Eleventh Five-year Plan, 100,000,000 tonnes of obsolete iron-making capacity and 55,000,000 tonnes of obsolete steel-making capacity will be phased out, with respective annual phase-out targets of 30,000,000 tonnes and 35,000,000 tonnes.

In light of the aforementioned situation, the Company will strive for further progress in its standardisation effort to enhance work efficiency. The implementation of the low-cost strategy and the brand strategy will be accelerated to further reduce costs and enhance efficiency, while the quality and quantity of products will be substantially improved to meet the State's rising demand on quality steel products for fixed asset investments and important infrastructure developments. The construction of the new area and technological renovation of the existing production lines will be accelerated, thereby rapidly raising the output of high added-value products and increasing economic efficiency. While raising its advanced production capacity and expanding its operating scale, the Company will closely monitor the progress of phasing out obsolete production capacity in the country and the integration and restructuring of domestic and international iron and steel enterprises, so as to capitalise on any favourable opportunity to achieve better and faster development.

(15) Long-term strategies of the Company

From 2007 to 2010, the Company will continue to implement the overall planning for technological renovations and structural adjustments of the Eleventh Five-year Plan. The 5,000,000-tonne thin plate production capacity to be added in 2007 will be entirely producing cold-rolled and hot-rolled thin plate products, with part of such products being high-end plates needed by the automobile and home appliance industries, where there are shortages of such materials. The commencement of such production projects will substantially increase the percentage of plates and belts in the Company's output, while the overall product competitiveness and market risk-aversion ability will be significantly enhanced as well, thereby substantially raising the Company's profitability. The Company will also study the implementation of the technological renovations and structural adjustments for the later period of the Eleventh Five-year Plan and the corresponding organisational and systematic reforms, so as to further strengthen the principal iron and steel operation.