

## 1. MATERIAL LITIGATION OR ARBITRATION

During the period, the Company did not involve in any material litigation or arbitration.

## 2. MATERIAL CONTRACTS WITH HOLDING COMPANY

### (1) Service and Supply Agreement

On 20th October 2005, the Company and the Holding Company entered into the New Service and Supply Agreement (the "New Service and Supply Agreement") to amend certain terms of the Service and Supply Agreement dated 29th September 1997 (the "Original Service and Supply Agreement"). The New Service and Supply Agreement contains substantially the same terms as the Original Service and Supply Agreement, save that the Holding Company agreed to continue to supply or to procure its subsidiaries (the Holding Company and its subsidiaries, excluding the Company, are hereinafter collectively referred to as the "Parent Group") to supply certain equipments and materials and provide certain welfare and support services to the Company; the Company agreed to continue to supply certain materials and provide certain services to the Parent Group; the Company and the Parent Group will allow each other to use and occupy their respective factory premises. The term of the New Service and Supply Agreement is three years with effect from 1st January 2005 till 31st December 2007; the fees payable in respect of such services are determined by reference to market prices or profit mark-up above the cost / depreciation or prices prescribed by the relevant Chongqing governmental departments (as applicable).

### (2) Lease Agreements

Under the lease agreements dated 14th August 1997 and 13th August 1997, as amended by a supplementary agreement dated 29th September 1997, the Company and Hengda leased land on which the Company's plants are located from the Holding Company for a term of 50 years from 14th August 1997 and 13th August 1997 respectively. For the years 1998 to 2000, the total rental was Rmb11,994,000 per annum. Thereafter, the rent will be adjusted subject to a maximum increment of 10% of the latest applicable rental amount every three years by negotiation between the Company and the Holding Company.

On 12th January 2001, the Holding Company entered into supplementary agreements with the Company and Hengda respectively in respect of the adjustment on the rent for the lease of land. The rent for the lease of land from the Holding Company was increased at 10% based on the latest applicable rental amount. The annual rent amount paid by the Company was approximately Rmb13,200,000 for the years 2001 to 2003.

On 8th December 2002, the Company and the Holding Company entered into the Lease Agreement to rent the land with an area of 216,430 square meters, which is currently occupied by Henda, for a term of 45 years. The rental is Rmb1,028,475 per annum and such rental may be adjusted after 1st January 2004 and for at least every three years after the last rent adjustment. Any adjustment made shall not exceed 10% of the rent paid by the Company at that time.

On 20th October 2005, the Company and the Holding Company entered into the Supplemental Lease Agreement to shorten the duration of the two Land Lease Agreements dated 14th August 1997 and 8th December 2002 from 50 years to 20 years and from 45 years to 15 years respectively.

Pursuant to the Lease Agreement entered into between the Company and the Holding Company on 10th February 2006, the Company will lease another parcel of land with an area of 337,473 square meters for a term of three years from 1st January 2006 to 31st December 2008 from the Holding Company. The rental for each of the three years from 2006 to 2008 will be Rmb1,764,986, Rmb1,940,472 and Rmb1,940,472 respectively.

### 3. CONNECTED TRANSACTION

- **Connected Transactions related to Ongoing Operations**

**(1) Continuing connected transactions constituted by the New Service and Supply Agreement**

On 20th October 2005, the Company and the Holding Company entered into the New Service and Supply Agreement with a term of three years from 1st January 2005 to 31st December 2007.

Pursuant to the New Service and Supply Agreement, the Parent Group has agreed to continually supply certain equipments and materials and provide social welfare services (including medical, unemployment and pension funds management) to the Company, the fees in respect of which will be paid by the Company through the Parent Group but no fee will be charged by the Parent Group for managing such social welfare services for the Company's employees; the Company has also agreed to continue to supply certain materials and provide certain services to the Parent Group; the Company and the Parent Group will allow each other to use and occupy their respective factory premises. According to the Original Service and Supply Agreement, the Company and the Parent Group has been mutually providing raw materials, production materials, social and utility services to each other since 1997. As the transactions between the Company and the Parent Group are of recurring nature, the continuation of the said transactions is necessary to facilitate and consolidate the business of the Company and the Parent Group.

Since the Holding Company holds approximately 61.09% of the issued share capital of the Company, the provision and receipt of services and materials by the Company under the New Service and Supply Agreement constitute continuing connected transactions of the Company under the Listing Rules.

Pursuant to the New Service and Supply Agreement, the annual consideration paid by the Parent Group to the Company is as follows:

|  | Year ended<br>31st December<br>2005<br><i>Rmb</i> | Year ending<br>31st December<br>2006<br><i>Rmb</i> | Year ending<br>31st December<br>2007<br><i>Rmb</i> |
|--|---|--|--|
| Product Cap of the Company<br>(including water, electricity and natural gas, steel products (steel plates, billets, etc.) and ancillary products (cement, hardware, timber etc.) used in the production process of the Parent Group) | 1,020,000,000                                     | 1,250,000,000                                      | 1,400,000,000                                      |
| Service Cap of the Company<br>(Railway transportation and others (technical services such as quality control, technical consultancy services etc.))  | 4,600,000   | 7,200,000  | 11,000,000   |
| Lease Cap of the Company<br>(Lease of the Company's factory premises)  | 1,400,000   | 2,800,000  | 4,000,000  |
| <b>Subtotal</b>  | <b>1,026,000,000</b>                              | <b>1,260,000,000</b>                               | <b>1,415,000,000</b>                               |

## SIGNIFICANT EVENTS (CONTINUED)

### 3. CONNECTED TRANSACTION (Continued)

#### (1) Continuing connected transactions constituted by the New Service and Supply Agreement (Continued)

Pursuant to the New Service and Supply Agreement, the annual consideration paid by the Company to the Parent Group is as follows:

|  | Year ended<br>31st December<br>2005<br>Rmb | Year ending<br>31st December<br>2006<br>Rmb | Year ending<br>31st December<br>2007<br>Rmb |
|--|--|---|---|
| Product cap of the Parent Group<br>(Products (such as oxygen,<br>equipment and spare parts etc.)<br>and raw materials (such as pig iron,<br>iron ore, ferroalloy, scrap steel,<br>refractory materials, and ancillary<br>products (including white marble,<br>limestone) etc.) | 1,230,000,000                              | 1,450,000,000                               | 1,700,000,000                               |
| Service cap of the Parent Group<br>(Transportation services,<br>environmental services, technical services<br>(such as construction service,<br>property, plant and equipment<br>project monitoring service, software<br>development service and<br>labour service etc.)       | 390,000,000                                | 350,000,000                                 | 350,000,000                                 |
| Lease cap of the Parent Group<br>(Lease of the Parent Group's<br>factory premises)   | 600,000                                    | 600,000                                     | 600,000                                     |
| Welfare cap  | 93,200,000                                 | 100,000,000                                 | 106,800,000                                 |
| Subtotal   | 1,713,800,000                              | 1,900,600,000                               | 2,157,400,000                               |

### 3. CONNECTED TRANSACTION *(Continued)*

#### (1) Continuing connected transactions constituted by the New Service and Supply Agreement *(Continued)*

Basis of price  
determination:

(i) the annual cap of raw materials including (steel products (steel plates, billets, etc.), pig iron, iron ore, ferroalloy, scrap steel, refractory materials, as well as ancillary products (white marble, limestone etc.) are determined by reference to the current market price of such materials and profit mark-up above the cost of providing such products as agreed between the Company and the Parent Group respectively; (ii) the annual cap of equipment and spare parts were determined by reference to the price offered by suppliers of such equipment and spare parts; (iii) the annual cap of water, electricity and natural gas supply and social welfare services were determined by reference to the prices as prescribed by the relevant Chongqing governmental departments; (iv) the annual cap of transportation services and the provision of oxygen were determined by reference to market prices; (v) the annual cap of technical services were determined primarily by reference to market prices or a profit mark-up above the cost of providing such services as agreed between the Company and the Parent Group or prices prescribed by the relevant Chongqing governmental departments (as the case may be, depending on the nature/type of technical services provided); (vi) the annual cap of railway transportation services and environmental services were determined by reference to a profit mark-up above the cost of providing such services as agreed between the Company and the Parent Group; and (vii) the annual cap of the lease of factory premises was determined by reference to a mark-up for maintenance over and above the cost of depreciation of the factory premises.

For the year ended 31st December 2006, the amount paid under the New Service and Supply Agreement between the Company and the Parent Group are set out as follows: (in Rmb'000):

#### (2) Connected transactions constituted by the Lease Agreements

Pursuant to the land lease agreement dated 14 August 1997 and its supplemental lease agreement ("First Land Lease"), the land lease agreement dated 8 December 2002 and its supplemental lease agreement ("Second Land Lease"), and the land lease agreement dated 10 February 2006 ("Third Land Lease") entered into between the Company and its Holding Company, the Company leased from the Holding Company lands with area of 2,559,973 square meters, 216,430 square meters and 337,473 square meters respectively, with respective term of 20 years, 15 years and 3 years. The leases are renewable upon maturity.

Pursuant to the First Land Lease, the yearly rent was Rmb4.32 per square meter without adjustment within 3 years and thereafter the yearly rent may be adjusted at intervals of not less than 3 years provided that each increment shall not exceed 10% of the then prevailing yearly rent, namely each adjusted yearly rent shall not exceed 110% of the then prevailing yearly rent. With effect from 1 January 2001 and 1 January 2004, the yearly rent was increased to Rmb4.75 per square meter and Rmb5.23 per square meter respectively.

Pursuant to the Second Land Lease, the yearly rent was Rmb4.75 per square meter, which was adjusted to Rmb5.23 per square meter since 1 January 2004. Thereafter the yearly rent may be adjusted at intervals of not less than 3 years provided that each increment shall not exceed 10% of the then prevailing yearly rent, namely each adjusted yearly rent shall not exceed 110% of the then prevailing yearly rent.

The yearly rent under the Third Land Lease was determined with reference to the same in the First Land Lease and the Second Land Lease, being Rmb5.23 per square meter for 2006 and Rmb5.75 per square meter for 2007 and 2008.

## SIGNIFICANT EVENTS (CONTINUED)

### 3. CONNECTED TRANSACTION (Continued)

#### (3) Connected transactions of the Company during the year ended 31st December 2006

- Details of the major related party transactions entered into by the Company during the year ended 31st December 2006 are set out in note 29 to the financial statements and note 5(5) to the financial statements prepared under the PRC accounting standards and regulations. Such transactions also constituted connected transactions under the Listing Rules.

| Related party   | Amount  | Percentage in similar transactions (%) | Amount    | Percentage in similar transactions (%) |
|---|---------|--|-----------|--|
| Chongqing Iron & Steel Group Mining Company Limited                       | 10,490  | 4.48                                   | 625,294   | 20.84                                  |
| Chongqing Iron & Steel Group Iron Company Limited                         | —       | —                                      | 373,532   | 57.51                                  |
| Chongqing Iron & Steel Group Construction and Engineering Company Limited | 16,714  | 0.19                                   | 57,412    | 7.97                                   |
| Chongqing Iron & Steel Group Chaoyang Gas Company Limited                 | 148,945 | 68.68                                  | 217,215   | 99.31                                  |
| Chongqing Xinteng Metallurgical Burden Materials Company Limited          | —       | —                                      | 914       | 0.24                                   |
| Chongqing Iron & Steel Group Machinery Manufacturing Company Limited      | 35,034  | 0.39                                   | 61,290    | 8.50                                   |
| Chongqing Iron & Steel Group Electronic Company Limited                   | —       | —                                      | 21,052    | 2.92                                   |
| Chongqing Iron & Steel Group Refractory Materials Company Limited         | —       | —                                      | 11,686    | 18.32                                  |
| Chongqing Iron & Steel Group Thermal Ceramics Company Limited             | —       | —                                      | 8,414     | 13.19                                  |
| Chongqing Iron & Steel Group Logistics Services Company Limited           | —       | —                                      | 4,281     | 42.63                                  |
| Chongqing Iron & Steel Group Zhongxing Industrial Company Limited         | —       | —                                      | 1,399     | 0.19                                   |
| Chongqing Si Gang Steel Company Limited                                   | 281,408 | 3.17                                   | 4,094     | 0.67                                   |
| Chongqing Iron & Steel Group Steel Pipe Company Limited                   | 129,208 | 1.45                                   | —         | —                                      |
| Chongqing San Gang Steel Company Limited                                  | 106,683 | 1.20                                   | —         | —                                      |
| Chongqing Iron & Steel Group Export and Import Company Limited            | 2,764   | 0.03                                   | —         | —                                      |
| Chongqing Iron & Steel Group Doorlead Realty Co., Ltd.                    | 1,664   | 0.77                                   | —         | —                                      |
| Chongqing Iron & Steel Group Transportation Company Limited               | 6,309   | 2.91                                   | —         | —                                      |
| Others  | 14,978  | —                                      | 46,744    | —                                      |
| Total   | 754,197 | —                                      | 1,433,327 | —                                      |

### 3. CONNECTED TRANSACTION *(Continued)*

#### (3) Connected transactions of the Company during the year ended 31st December 2006 *(Continued)*

In addition, during the reporting period, the amount of connected transactions in respect to the Company's provision of labour service and receipt of labour services to/or the parent and its subsidiaries amounted to RMB 3 million and RMB 264 million, respectively, and the land rental and advance paid on behalf of others payable to the controlling shareholder was RMB16 million and RMB 81 million, respectively.

Based on the work performed, the auditors of the Company have confirmed that the aforesaid continuing connected transactions (a) have been approved by the Board of Directors of the Company; (b) have not exceeded the relevant caps as described in the continuing connected transactions Agreements; and (c) have been entered into in accordance with the terms of the continuing connected transactions Agreements governing the transactions.

The independent directors of the Company have reviewed the above continuing connected transactions and confirmed that they were carried out: (a) in the usual and ordinary course of business of the Company; (b) on normal business terms or terms no less favorable than those available to or from independent third parties; and (c) on terms set out in agreements governing the relevant transactions which are fair and reasonable and in the interests of the Company and its shareholders as a whole.

### 4. EMPLOYEE SOCIAL SECURITY AND BENEFITS

The Company participates in employee social security plans, including pension and medical insurance, housing and other welfare benefits organized by the government bodies in accordance with relevant regulations of the PRC. In addition, the Company also participated in the supplementary non-social pension plan organized by the Parent Group for retired employees. The Company makes direct contribution to plans of employee social basic pension, basic housing fund, occupational injury insurance and maternity insurance organized by labor and social security bodies, and makes welfare contribution to other non-social retirement benefit plans through the Parent Group which charges no fees therefore.

Save for the above security and benefit plans as required, the Company has no additional commitment to other pension or welfare benefits. The Parent Group is liable for payment of any other payable employee benefit and pension expense other than the above-mentioned benefit and pension expenses.

### 5. INCOME TAX

The Company is established as a foreign-invested joint stock limited company under the approval ([1998] Wai Jing Mao Zi Er Han Zi No. 748) issued by the Ministry of Foreign Trade and Economic Cooperation on 7th December 1998. As a production enterprise with foreign investment established at the riverside of Yangtse River, the Company was originally entitled to a preferential enterprise income tax rate of 24% in accordance with "The Notice issued by the State Tax Bureau on Taxation Policy Concerning Foreign Invested Enterprises for Further Opening of Frontier, Coastal, Inland and Riverside Cities" (Guo Shui Fa [1992] No. 218). In April 2003, the Company obtained the "Reply to Application of Preferential Enterprise Income Tax for Enterprises in Western Development by Chongqing Iron & Steel Company Limited" (Yu Guo Shui Han [2003] No. 57 issued by the State Administration of Taxation of Chongqing and the "Reply to Application of Preferential Enterprise Income Tax for Enterprises in Western Development by Chongqing Iron & Steel Company Limited" (Da Dukou Guo Shui Han [2003] No. 8) issued by the State Administration of Taxation of Da Dukou District, Chongqing. In accordance with these approvals, the Company is entitled to the preferential income tax policy applicable to enterprises in the western development region and the income tax rate is reduced to 15% for the period from 2001 to 2010. The Company was exempted from landowner income tax during year 2006 and 2005.

The Company purchased certain domestic manufactured equipment during the period from 2004 to 2005. In accordance with Cai Shui Zi [2000] No. 49 "The Notice concerning the Reduction in Corporate Income Tax for Purchase of Domestic Manufactured Equipment by Enterprises with Foreign Investment and Foreign Enterprises" issued by the Ministry of Finance and the State Administration of Taxation, part of the purchase costs of the domestic manufactured equipment could be utilized to reduce the Company's enterprise income tax.

## SIGNIFICANT EVENTS (CONTINUED)

### 5. INCOME TAX *(Continued)*

In accordance with the approval (Da Dukou Guo Shui Han [2006] No.3) on application for income tax reduction lodged by the Company relating to the purchase of domestic manufactured equipment in 2005 and the application form for the same in 2006 both approved by the State Administration of Taxation of Da Dukou District, Chongqing, the Company is entitled to a tax reduction of Rmb170,821,000 during the period from 2005 to 2006. Of them, Rmb12,178,000 and Rmb52,394,000 were utilized to offset the Company's income tax liability for 2005 and 2006 respectively. The remaining Rmb24,542,000 approved in 2005 and Rmb81,707,000 approved in 2006 can be utilized to prospectively offset the additional enterprise income tax of each next year over the year in which the domestic manufactured equipment is purchased for a term not more than 5 years.

### 6. AUDITORS

The Board of Directors will propose to the 2006 Annual General Meeting to appoint KMPG Huazhen and KMPG as its domestic auditors and international auditors for 2007 respectively.

### 7. DURING THE YEAR, THE COMPANY WAS NOT INVOLVED IN ANY MATERIAL CUSTODY, CONTRACTING OR LEASING OF ASSETS FOR OTHER PARTIES OR OF ITS ASSETS BY OTHER PARTIES, NOR DID IT ENTRUST ANY PARTY FOR CASH ASSET MANAGEMENT.

### 8. DURING THE REPORTING PERIOD, NONE OF THE COMPANY OR SHAREHOLDERS HOLDING 5% OR MORE OF ITS SHARE CAPITAL DISCLOSED ANY ISSUE AS UNDERTAKEN WHICH IS DISCLOSEABLE DURING THE REPORTING PERIOD OR SUBSISTING AT THE DATE OF THIS ANNUAL REPORT, AND NONE OF THE COMPANY, DIRECTORS AND SENIOR MANAGEMENT MEMBER OF THE COMPANY HAS BEEN A SUBJECT OF INSPECTION, ADMINISTRATIVE PUNISHMENT, REPRIMAND BY ANNOUNCEMENT OR PUBLIC CENSURE.