BALANCE SHEET

As at 31st December 2006

	Note	As at 31 December 2006 Rmb'000	2005 Rmb'000
ASSETS			
Non-current assets			
Property, plant and equipment	6	**5,532,413**	5,054,737
Land use right	7	**26,914**	27,290
Available-for-sale financial asset	8	**5,000**	5,000
Deferred income tax assets	9	**2,938**	2,493
Trade and other receivables	11	**62,600**	71,600
		5,629,865	5,161,120
Current assets			
Inventories	10	**2,146,968**	1,849,341
Trade and other receivables	11	**688,061**	636,878
Prepayment for income tax		**21,871**	20,378
Restricted cash	12	**63,870**	13,342
Cash and cash equivalents	13	**313,772**	451,220
		3,234,542	2,971,159
Total assets		**8,864,407**	8,132,279
EQUITY			
Capital and reserves attributable to the Company's equity holders			
Share capital	14	**1,383,127**	1,063,944
Other reserves	15	**954,204**	922,720
Retained earnings			
— Proposed final dividend		**173,313**	159,592
— Others		**1,389,133**	1,769,668
Total equity		**3,899,777**	3,915,924
LIABILITIES			
Non-current liabilities			
Borrowings	17	**295,000**	705,000
Trade and other payables	16	**233,038**	126,144
Deferred income	18	**77,304**	10,154
		605,342	841,298
Current liabilities			
Trade and other payables	16	**2,011,635**	1,468,247
Borrowings	17	**2,347,653**	1,906,810
		4,359,288	3,375,057
Total liabilities		**4,964,630**	4,216,355
Total equity and liabilities		**8,864,407**	8,132,279
Net current liabilities		**(1,124,746)**	(403,898)
Total assets less current liabilities		**4,505,119**	4,757,222

The notes on pages 50 to 76 are an integral part of these financial statements.

INCOME STATEMENT

FOR THE YEAR ENDED 31 DECEMBER 2006

	Note	As at 31 December 2006 Rmb'000	 2005 Rmb'000
Sales	5	**9,621,897**	8,856,126
Cost of goods sold	20	**(8,752,529)**	(8,128,093)
Gross profit		**869,368**	728,033
Selling and marketing costs	20	**(195,785)**	(150,380)
Administrative expenses	20	**(191,028)**	(176,352)
Other gains - net	19	**9,037**	6,463
Operating profit		**491,592**	407,764
Finance costs	22	**(184,010)**	(132,120)
Profit before income tax		**307,582**	275,644
Income tax expense	23	**(53,487)**	(44,841)
Profit for the year		**254,095**	230,803
Attributable to:			
Equity holders of the Company		**254,095**	230,803
Earnings per share for profit attributable to the equity holders of the Company during the year			
— Basic and diluted	24	**Rmb0.184**	Rmb0.167
Dividends	25	**283,963**	159,592

The notes on pages 50 to 76 are an integral part of these financial statements.

STATEMENT OF CHANGES IN EQUITY

FOR THE YEAR ENDED 31 DECEMBER 2006

	Note	Attributable to the equity holders of the Company Share capital *Rmb'000*	Other reserves *Rmb'000* *(Note 15)*	Retained earnings *Rmb'000*	Total *Rmb'000*
Balance at 1 January 2005		1,063,944	883,785	1,896,984	3,844,713
Profit for the year		—	—	230,803	230,803
Cash dividend relating to 2004	25	—	—	(159,592)	(159,592)
Transfer to reserves	15	—	38,935	(38,935)	—
Balance at 31 December 2005		1,063,944	922,720	1,929,260	3,915,924
Balance at 1 January 2006		1,063,944	922,720	1,929,260	3,915,924
Profit for the year		—	—	254,095	254,095
Cash dividend relating to 2005	25	—	—	(159,592)	(159,592)
Cash dividend relating to 2006	25	—	—	(110,650)	(110,650)
Bonus dividend relating to 2005	25	319,183	—	(319,183)	—
Transfer to reserves	15	—	31,484	(31,484)	—
Balance at 31 December 2006		1,383,127	954,204	1,562,446	3,899,777

The notes on pages 50 to 76 are an integral part of these financial statements.

CASH FLOW STATEMENT

FOR THE YEAR ENDED 31 DECEMBER 2006

	Note	As at 31 December 2006 *Rmb'000*	 2005 *Rmb'000*
CASH FLOWS FROM OPERATING ACTIVITIES			
Cash generated from operations	26	**857,262**	298,599
Interest paid		**(173,507)**	(129,544)
Income tax paid		**(3,031)**	(73,304)
Net cash generated from operating activities		**680,724**	95,751
CASH FLOWS FROM INVESTING ACTIVITIES			
Purchase of property, plant and equipment		**(612,408)**	(1,254,098)
Proceeds from disposals of property, plant and equipment	26(a)	**3,686**	20,394
Decrease of bank deposits with maturity over 3 months		**—**	165,530
Interest received		**4,435**	9,385
Net cash used in investing activities		**(604,287)**	(1,058,789)
CASH FLOWS FROM FINANCING ACTIVITIES			
Proceeds from borrowings		**2,676,357**	2,064,900
Repayments of borrowings		**(2,620,000)**	(1,225,748)
Dividends paid		**(270,242)**	(159,592)
Net cash (used in) generated from financing activities		**(213,885)**	679,560
Net decrease in cash and cash equivalents		**(137,448)**	(283,478)
Cash and cash equivalents at beginning of the year		**451,220**	734,698
Cash and cash equivalents at end of the year	13	**313,772**	451,220

The notes on pages 50 to 76 are an integral part of these financial statements.

1 GENERAL INFORMATION

Chongqing Iron and Steel Company Limited (the "Company") is a joint stock limited liability company established in the People's Republic of China (the "PRC") in August 1997 as part of the restructuring ("Restructuring") of a state-owned enterprise known as Chongqing Iron and Steel Company (Group) Limited (the "Holding Company"). Pursuant to the Restructuring, the principal iron and steel business undertakings and one of the subsidiaries of the Holding Company, Chongqing Hengda Steel Industrial Co., Ltd. ("Hengda"), were taken over by the Company, whereupon the Company issued 650,000,000 state-owned shares of Rmb1 each to the Holding Company. The H shares of the Company have been listed on The Stock Exchange of Hong Kong Limited since 17 October 1997.

In December 2002, the Company acquired all assets and liabilities of Hengda, the former subsidiary of the Company. At the same time, the Company disposed of its entire interest in Hengda to its Holding Company. Following the disposal of Hengda, the Company does not have any subsidiary.

The A shares of the Company have been listed on the Stock Exchange of Shanghai since 28 February 2007.

The Company is principally engaged in the manufacture and sale of steel products.

The address of the Company's registered office is No. 30, Gangtie Road, Dadukou District, Chongqing, the PRC.

These financial statements have been approved for issue by the Board of Directors on 20 April 2007.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The principal accounting policies applied in the preparation of these financial statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

(a) Basis of preparation

The financial statements of the Company have been prepared in accordance with Hong Kong Financial Reporting Standards ("HKFRS"). The financial statements have been prepared under the historical cost convention, as modified by the revaluation of financial assets and financial liabilities at fair value through profit or loss.

The preparation of financial statements in conformity with HKFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Company's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the financial statements, are disclosed in Note 4.

(i) Amendments to published standards effective in 2006

— HKAS19 (Amendment), Employee Benefits, is mandatory for the Company's accounting periods beginning on or after 1 January 2006. This amendment introduces the option of an alternative recognition approach for actuarial gains and losses. It may impose additional recognition requirements for multi-employer plans where insufficient information is available to apply defined benefit accounting. It also adds new disclosure requirements. As the Company does not have any actuarial gains and losses and does not participate in any multi-employer plans, adoption of this amendment does not have any impact on the Company's financial statements.

(ii) Standards and interpretations to existing standards that are not yet effective and have not been early adopted by the Company

— HKFRS 7, Financial instruments: Disclosures, and the complementary Amendment to HKAS 1, Presentation of Financial Statements - Capital Disclosures (effective for annual periods beginning on or after 1 January 2007). HKFRS 7 introduces new disclosures relating to financial instruments. The Company will apply HKFRS 7 and the complementary Amendment to HKAS 1 from 1 January 2007, but it is not expected to have any impact on the Company's financial statements;

— HK(IFRIC)-Int 8, Scope of HKFRS 2 (effective for annual periods beginning on or after 1 May 2006). HK(IFRIC)-Int 8 requires consideration of transactions involving the issuance of equity instruments - where the identifiable consideration received is less than the fair value of the equity instruments issued - to establish whether or not they fall within the scope of HKFRS 2. The Company will apply HK(IFRIC)-Int 8 from 1 January 2007, but it is not expected to have any impact on the Company's financial statements; and

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

(a) Basis of preparation *(Continued)*

(ii) Standards and interpretations to existing standards that are not yet effective and have not been early adopted by the Company ***(Continued)***

— HK(IFRIC)-Int 10, Interim Financial Reporting and Impairment (effective for annual periods beginning on or after 1 November 2006). HK(IFRIC)-Int 10 prohibits the impairment losses recognised in an interim period on goodwill, investments in equity instruments and investments in financial assets carried at cost to be reversed at a subsequent balance sheet date. The Company will apply HK(IFRIC)-Int 10 from 1 January 2007, but it is not expected to have any impact on the Company's accounts.

(iii) Interpretation to existing standards that are not yet effective and not relevant for the Company's operations

The following interpretations to existing standards have been published that are mandatory for the Company's accounting periods beginning on or after 1 May 2006 or later periods but are not relevant for the Company's operations:

— HK(IRFIC)-Int 7, Applying the Restatement Approach under HKAS 29, Financial Reporting in Hyperinflationary Economies (effective from 1 March 2006). HK(IFRIC)-Int 7 provides guidance on how to apply requirements of HKAS 29 in a reporting period in which an entity identifies the existence of hyperinflation in the economy of its functional currency, when the economy was not hyperinflationary in the prior period. As the Company's functional currency is not in a hyperinflationary economy, HK(IFRIC)-Int 7 is not relevant to the Company's operations; and

— HK(IFRIC)-Int 9, Reassessment of embedded derivatives (effective for annual periods beginning on or after 1 June 2006). HK(IFRIC)-Int 9 requires an entity to assess whether an embedded derivative is required to be separated from the host contract and accounted for as a derivative when the entity first becomes a party to the contract. Subsequent reassessment is prohibited unless there is a change in the terms of the contract that significantly modifies the cash flows that otherwise would be required under the contract, in which case reassessment if required. As the Company has not changed the terms of its contracts, HK(IFRIC)-Int 9 is not relevant to the Company's operations.

(iv) Standards, amendments and interpretations effective in 2006 but not relevant for the Company's operations

The following standards, amendments and interpretations are mandatory for accounting periods beginning on or after 1 January 2006 but are not relevant to the Company's operations:

— HKAS 21 Amendment - New Investment in a Foreign Operation;
— HKAS 39 Amendment - Cash Flow Hedge Accounting of Forecast Intragroup Transactions;
— HKAS 39 Amendment - The Fair Value Option;
— HKAS 39 and International Financial Reporting Standard ("IFRS") 4 Amendment - Financial Guarantee Contracts;
— HKFRS 6, Exploration for and Evaluation of Mineral Resources;
— HKFRS 1 Amendment - First-time Adoption of Hong Kong Financial Reporting Standards and IFRS 6 (Amendment), Exploration for and Evaluation of Mineral Resources;
— HK(IFRIC)-Int 4, Determining whether an Arrangement contains a Lease;
— HK(IFRIC)-Int 5, Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds; and
— HK(IFRIC)-Int 6, Liabilities arising from Participating in a Specific Market - Waste Electrical and Electronic Equipment.

(b) Segment reporting

A business segment is a group of assets and operations engaged in providing products or services that are subject to risks and returns that are different from those of other business segments. A geographical segment is engaged in providing products or services within a particular economic environment that are subject to risks and returns that are different from those segments operating in other economic environments.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

(c) Foreign currency translation

(i) Functional and presentation currency

Items included in the financial statements of the Company are measured using the currency of the primary economic environment in which the Company operates (the "functional currency"). The financial statements are presented in Renminbi ("Rmb"), which is the Company's functional and presentation currency.

(ii) Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement.

(d) Property, plant and equipment

Property, plant and equipment are stated at historical cost less depreciation and impairment losses. Historical cost includes expenditure that is directly attributable to the acquisition of the items.

Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Company and the cost of the item can be measured reliably. The carrying amount of the replaced part is derecognised. All other repairs and maintenance are charged in the income statement during the financial period in which they are incurred.

Depreciation of property, plant and equipment is calculated using the straight-line method to allocate their costs to their residual values over their estimated useful lives, as follows:

— Buildings	40-45 years
— Plant and machinery	8-22 years
— Transportation vehicles and equipment	8 years

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date.

An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount (Note 2(f)).

Construction in progress represents plant and property under construction and machinery under installation and testing and is stated at cost. This includes costs of construction, plant and equipment and other direct costs. Construction in progress is not depreciated until such time as the relevant assets are completed and are capable of operating in the manner intended by management.

Gains and losses on disposals are determined by comparing proceeds with carrying amount and are recognised within other gains - net, in the income statement.

(e) Land use right

Land use right acquired is classified as operating leases. The up-front prepayment made for the land use right is recognised in the income statement on a straight-line basis over the period of the land use right (50 years).

(f) Impairment of non-financial assets

Assets that have an indefinite useful life or have not yet been available for use are not subject to amortisation and are tested annually for impairment. Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units). Assets other than goodwill that suffered an impairment are reviewed for possible reversal of the impairment at each reporting date.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

(g) Financial assets

The Company classifies its financial assets in the following categories: loans and receivables and available-for-sale. The classification depends on the purpose for which the financial assets were acquired. Management determines the classification of its financial assets at initial recognition.

(i) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are included in current assets, except for maturities greater than 12 months after the balance sheet date. These are classified as non-current assets. Loans and receivables are classified as trade and other receivables in the balance sheet (Note 2(i)).

(ii) Available-for-sale financial assets

Available-for-sale financial assets are non-derivatives that are either designated in this category or not classified in any of the other categories. They are included in non-current assets unless management intends to dispose of the investment within 12 months of the balance sheet date.

Regular purchases and sales of financial assets are recognised on trade-date - the date on which the Company commits to purchase or sell the asset. Investments are initially recognised at fair value plus transaction costs for all financial assets not carried at fair value through profit or loss. Financial assets are derecognised when the rights to receive cash flows from the investments have expired or have been transferred and the Company has transferred substantially all risks and rewards of ownership. Available-for-sale financial assets are subsequently carried at fair value. Loans and receivables are carried at amortised cost using the effective interest method.

Changes in the fair value of monetary securities denominated in a foreign currency and classified as available-for-sale are analysed between translation differences resulting from changes in amortised cost of the security and other changes in the carrying amount of the security. The translation differences on monetary securities are recognised in profit or loss; translation differences on non-monetary securities are recognised in equity. Changes in the fair value of monetary and non-monetary securities classified as available for sale are recognised in equity.

When securities classified as available-for-sale are sold or impaired, the accumulated fair value adjustments recognised in equity are included in the income statement as gains or losses from investment securities.

Interest on available-for-sale securities calculated using the effective interest method is recognised in the income statement as part of other income. Dividends on available-for-sale equity instruments are recognised in the income statement as part of other income when the Company's right to receive payments is established.

Available-for-sale financial assets that do not have a quoted market price in an active market and whose fair value cannot be reliably measured, are measured at cost less impairment.

The Company assesses at each balance sheet date whether there is objective evidence that a financial asset or a group of financial assets is impaired. In the case of equity securities classified as available-for-sale, a significant or prolonged decline in the fair value of the security below its cost is considered an indicator that the securities are impaired. If any such evidence exists for available-for-sale financial assets, the cumulative loss - measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognised in profit or loss - is removed from equity and recognised in the income statement. Impairment losses recognised in the income statement on equity instruments are not reversed through the income statement. Impairment testing of trade receivables is described in Note 2(i).

If there is objective evidence that an impairment loss has been incurred on an unquoted equity instrument that is not carried at fair value because its fair value cannot be reliably measured, the amount of the impairment loss is measured as the difference between the carrying amount of the available-for-sale financial asset and the present value of estimated future cash flows discounted at the current market rate of return for a similar financial asset, and the impairment loss is recognised in the income statement. Such impairment losses shall not be reversed.

(h) Inventories

Inventories are stated at the lower of cost and net realisable value. Cost is determined using the weighted average method. The cost of finished goods and work in progress comprises design costs, raw materials, direct labour, other direct costs and related production overheads (based on normal operating capacity). It excludes borrowing costs. Net realisable value is the estimated selling price in the ordinary course of business, less applicable variable selling expenses.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

(i) Trade and other receivables

Trade and other receivables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method, less provision for impairment. A provision for impairment of trade and other receivables is established when there is objective evidence that the Company will not be able to collect all amounts due according to the original terms of receivables. Significant financial difficulties of the debtor, probability that the debtor will enter bankruptcy or financial reorganisation, and default or delinquency in payments are considered indicators that the trade receivable is impaired. The amount of the provision is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the original effective interest rate. The carrying amount of the assets is reduced through the use of an allowance account, and the amount of the loss is recognised in the income statement within administrative expenses. When a trade receivable is uncollectible, it is written off against the allowance account for trade receivables. Subsequent recoveries of amounts previously written off are credited against administrative expenses in the income statement.

(j) Cash and cash equivalents

Cash and cash equivalents include cash in hand, deposits held at call with banks, other short-term highly liquid investments with original maturities of three months or less, and bank overdrafts. Bank overdrafts are shown within borrowings in current liabilities on the balance sheet.

(k) Share capital

Share capital is classified as equity. Incremental costs directly attributable to the issue of new shares or options are shown in equity as a deduction, net of tax, from the proceeds.

(l) Trade payables

Trade payables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method.

(m) Borrowings

Borrowings are recognised initially at fair value, net of transaction costs incurred. Borrowings are subsequently stated at amortised cost; any difference between the proceeds (net of transaction costs) and the redemption value is recognised in the income statement over the period of the borrowings using the effective interest method.

Borrowing costs incurred are recognised in the income statement.

Borrowings are classified as current liabilities unless the Company has an unconditional right to defer settlement of the liability for at least 12 months after the balance sheet date.

(n) Deferred income tax

Deferred income tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. However, the deferred income tax is not accounted for if it arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss. Deferred income tax is determined using tax rates (and laws) that have been enacted or substantially enacted by the balance sheet date and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled.

Deferred income tax assets are recognised to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised.

(o) Pension obligations

The Company's employees participate in defined contribution retirement schemes organised by the municipal government and the Holding Company whereby the Company is required to make monthly contributions to the plans at certain percentages of the employees' salaries. The municipal government and the Holding Company have respectively undertaken to assume the retirement benefit obligation of all existing and future retired employees' payable under the relevant plans. The Company has no obligation for the payment of retirement and other post-retirement benefits of employees other than the monthly contributions described above. Contributions to the retirement benefit schemes are recognised as employee benefit expense and recognised in the income statement as incurred.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(p) Provisions

Provisions for environmental restoration, restructuring costs and legal claims are recognised when: the Company has a present legal or constructive obligation as a result of past events; it is probable that an outflow of resources will be required to settle the obligation; and the amount has been reliably estimated. Restructuring provisions comprise lease termination penalties and employee termination payments. Provisions are not recognised for future operating losses.

Where there are a number of similar obligations, the likelihood that an outflow will be required in settlement is determined by considering the class of obligations as a whole. A provision is recognised even if the likelihood of an outflow with respect to any one item included in the same class of obligations may be small.

Provisions are measured at the present value of the expenditures expected to be required to settle the obligation using a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the obligation. The increase in the provision due to passage of time is recognised as interest expense.

(q) Revenue recognition

Revenue comprises the fair value of the consideration received or receivable for the sale of goods and services in the ordinary course of the Company's activities. Revenue is shown net of value-added tax, returns, rebates and discounts and after eliminating sales within the Company.

The Company recognises revenue when the amount of revenue can be reliably measured, it is probable that future economic benefits will flow to the entity and specific criteria have been met for each of the Company's activities as described below. The amount of revenue is not considered to be reliably measurable until all contingencies relating to the sale have been resolved. The Company bases its estimates on historical results, taking into consideration the type of customer, the type of transaction and the specifics of each arrangement.

(i) Sales of goods

Revenue from the sale of goods is recognised when significant risks and rewards of ownership of the goods are transferred to the customer, the customer has accepted the products and collectibility of the related receivables is reasonably assured.

(ii) Provision of services

Provision of transportation and other services are recognised in the accounting period in which the services are rendered.

(iii) Interest income

Interest income is recognised on a time-proportion basis using the effective interest method. When a receivable is impaired, the Company reduces the carrying amount to its recoverable amount, being the estimated future cash flow discounted at the original effective interest rate of the instrument, and continues unwinding the discount as interest income. Interest income on impaired loans is recognised using the original effective interest rate.

(iv) Operating lease (as the lessor)

Operating lease rental income (as the lessor) is recognised on a straight-line basis over the period of the lease.

(r) Operating lease (as the lessee for operating leases)

Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases (net of any incentives received from the lessor) are charged to the income statement on a straight-line basis over the period of the lease.

(s) Government grants

Grants from the government are recognised at their fair value where there is a reasonable assurance that the grant will be received and the Company will comply with all attached conditions.

Government grants relating to costs are deferred and recognised in the income statement over the period necessary to match them with the costs that they are intended to compensate.

Government grants relating to the purchase of property, plant and equipment are included in non-current liabilities as deferred government grants and are credited to the income statement on a straight line basis over the expected lives of the related assets.

(t) Dividend distribution

Dividend distribution to the Company's shareholders is recognised as a liability in the Company's financial statements in the period in which the dividends are approved by the Company's shareholders.

3 FINANCIAL RISK MANAGEMENT

(a) Financial risk factors

The Company's activities expose it to a variety of financial risks: market risk (including currency risk, fair value interest rate risk, cash flow interest rate risk and price risk), credit risk, and liquidity risk. The Company's overall risk management programme focuses on the unpredictability of financial markets and seeks to minimise potential adverse effects on the Company's financial performance.

Risk management is carried out by the Finance Department under policies approved by the Board of Directors. The Finance Department identifies, evaluates and hedges financial risks in close co-operation with the Company's operating units. The Board provides written principles for overall risk management, as well as written policies covering specific areas, such as foreign exchange risk, interest-rate risk, credit risk, and investing of excess liquidity

(i) Market risk

(1) Foreign exchange risk

The Company has assets and liabilities that are subject to fluctuations in foreign currency exchange rates. However, the Company does not use any derivative instruments to reduce its economic exposure to changes in exchange rates. As at 31 December 2006, the Company had the following foreign currency denominated assets and liabilities:

	2006 ***Rmb'000***	2005 *Rmb'000*
Cash at bank		
— US Dollar ("Usd") denominated	**589**	10,556
— HK Dollar ("Hkd") denominated	**41**	42
	630	10,598
Bank borrowings		
— Usd denominated	**58,565**	242,160

(2) Price risk

As the Company sells steel products at market prices, it is exposed to fluctuations in these prices.

(3) Cash flow and fair value interest rate risk

As the Company has no significant interest-bearing assets, the Company's income and operating cash flows are substantially independent of changes in market interest rates.

The Company's interest-rate risk arises from borrowings, and trade and other payables as disclosed in Note 16. Borrowings issued at variable rates expose the Company to cash flow interest-rate risk. Borrowings issued at fixed rates expose the Company to fair value interest-rate risk. The Company policy is to maintain most of its borrowings in fixed rate instruments. At the year end, 85% of the borrowings were at fixed rates.

(ii) Credit risk

The Company has no significant concentrations of credit risk. It has policies in place to ensure that sales of products are made to customers with an appropriate credit history. It also has policies that limit the amount of credit exposure to any financial institution.

3 FINANCIAL RISK MANAGEMENT *(Continued)*

(a) Financial risk factors *(Continued)*

(iii) Liquidity risk

Prudent liquidity risk management includes maintaining sufficient cash and the availability of funding from an adequate amount of committed credit facilities. Due to the dynamic nature of the underlying businesses, the Finance Department maintains flexibility in funding by maintaining availability under committed credit lines.

The table below analyses the Company's financial liabilities that will be settled on a net basis into relevant maturity groupings based on the remaining period at the balance sheet to the contractual maturity date. The amounts disclosed in the table are the contractual undiscounted cash flows. Balances due within 12 months equal their carrying balances, as the impact of discounting is not significant.

	Less than 1 year	Between 1 and 2 years	Between 2 and 5 years
At 31 December 2006			
Bank borrowings	2,347,653	295,000	—
Trade and other payables	2,011,635	135,256	103,452
At 31 December 2005			
Bank borrowings	1,906,810	505,000	200,000
Trade and other payables	1,468,247	121,246	8,150

(b) Fair value estimation

The fair value of financial instruments that are not traded in an active market is determined by using valuation techniques. The Company uses a variety of methods and makes assumptions that are based on market conditions existing at each balance sheet date. Valuation techniques, such as estimated discounted cash flows, are used to determine fair value for the financial instruments.

The carrying value less impairment provision of trade receivables and payables are a reasonable approximation of their fair values. The fair value of financial liabilities for disclosure purposes is estimated by discounting the future contractual cash flows at the current market interest rate that is available to the Company for similar financial instruments.

4 CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS

Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

(a) Critical accounting estimates and judgements

The Company makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal the related actual results. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below.

(i) Fair value of financial assets and liabilities

The fair value of financial assets and liabilities that are not traded in an active market is determined by using valuation techniques. The Company uses its judgement to select a variety of methods and make assumptions that are mainly based on market conditions existing at each balance sheet date. The Company has used discounted cash flow analysis for various financial assets and liabilities that were not traded in active markets.

(ii) Depreciation and amortisation

The Company's management determines the estimated residual value, useful lives and related deprecation/amortisation charges for the property, plant and equipment and land use rights with reference to the estimated periods that the Company intends to derive future economic benefits from the use of these assets. Management will revise the depreciation and amortisation charge where useful lives are different to previously estimated, or it will write-off or write-down technically obsolete or non-strategic assets that have been abandoned or sold.

(iii) Estimated impairment of property, plants and equipment

The Company tests annually whether property, plants and equipment has suffered any impairment, in accordance with the accounting policy stated in Note 2(f). The recoverable amounts of cash-generating units have been determined based on value-in-use calculations. These calculations require the use of estimates.

(b) Critical judgements in applying the entity's accounting policies

During the year, the Company has no judgements that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year.

5 SEGMENT INFORMATION

The Company mainly conducts its business within one business segment - the business of manufacture and sale of steel products in the PRC. No segment statement of income has been prepared by the Company for the year ended 31 December 2006. The Company also mainly operates within one geographical segment because its revenue is primarily generated in the PRC and its assets are located in the PRC. Accordingly, no geographical segment data is presented.

6 PROPERTY, PLANT AND EQUIPMENT

	Buildings *Rmb'000*	Plant and machinery *Rmb'000*	Transportation vehicles and equipment *Rmb'000*	Construction in progress *Rmb'000*	Total *Rmb'000*
At 1 January 2005					
Cost	1,720,000	3,475,008	23,007	1,209,390	6,427,405
Accumulated depreciation and impairment	(747,658)	(1,624,170)	(16,267)	(677)	(2,388,772)
Net book amount	972,342	1,850,838	6,740	1,208,713	4,038,633
Year ended 31 December 2005					
Opening net book amount	972,342	1,850,838	6,740	1,208,713	4,038,633
Additions	4,156	16,139	—	1,240,792	1,261,087
Transfers	228,297	759,684	746	(988,727)	—
Disposals *(Note 26)*	(5,813)	(22,932)	(151)	(337)	(29,233)
Depreciation charge	(42,564)	(171,595)	(1,591)	—	(215,750)
Closing net book amount	1,156,418	2,432,134	5,744	1,460,441	5,054,737
At 31 December 2005					
Cost	1,932,374	4,160,322	21,535	1,460,441	7,574,672
Accumulated depreciation and impairment	(775,956)	(1,728,188)	(15,791)	—	(2,519,935)
Net book amount	1,156,418	2,432,134	5,744	1,460,441	5,054,737
Year ended 31 December 2006					
Opening net book amount	1,156,418	2,432,134	5,744	1,460,441	5,054,737
Additions	995	2,100	3,648	743,506	750,249
Transfers	486,684	936,499	308	(1,423,491)	—
Disposals *(Note 26)*	(4,621)	(2,516)	(541)	—	(7,678)
Depreciation charge	(47,658)	(215,149)	(2,088)	—	(264,895)
Closing net book amount	1,591,818	3,153,068	7,071	780,456	5,532,413
At 31 December 2006					
Cost	2,410,110	5,064,552	23,477	780,456	8,278,595
Accumulated depreciation and impairment	(818,292)	(1,911,484)	(16,406)	—	(2,746,182)
Net book amount	1,591,818	3,153,068	7,071	780,456	5,532,413

As at 31 December 2006, property, plant and equipment with an aggregate carrying amount of Rmb579,260,000 (2005: Rmb558,102,000) was pledged as security for the Company's borrowings (Note 17(a)).

As at 31 December 2006, the Company was in the process of obtaining ownership certificates of certain buildings with carrying amount of Rmb169,407,000 (2005: Rmb123,449,000).

As at 31 December 2006, property, plant and equipment with carrying amount of Rmb18,529,000 (2005: Rmb14,189,000) was fully depreciated and still in use.

Depreciation expense of Rmb259,883,000 (2005: Rmb211,432,000) has been charged in cost of goods sold, Rmb1,472,000 (2005: Rmb1,141,000) in selling and marketing costs and Rmb3,540,000 (2005: Rmb3,177,000) in administrative expenses (Note 20).

7 LAND USE RIGHT

The Company's interest in land use right represents prepaid operating lease payment for a parcel of land in the PRC with a lease period of 50 years. The net book amount of land use right is analysed as follows:

	2006 Rmb'000	2005 Rmb'000
Opening net book amount	**27,290**	27,666
Amortisation *(Note 20)*	**(376)**	(376)
Closing net book amount	**26,914**	27,290

As at 31 December 2006, land use right with carrying amount of Rmb26,914,000 (2005: Rmb27,290,000) was pledged as security for the Company's borrowings (Note 17(a)).

8 AVAILABLE-FOR-SALE FINANCIAL ASSET

	2006 Rmb'000	2005 Rmb'000
Unlisted shares, at cost	**5,000**	5,000

Non-current available-for-sale financial asset represents a 2% shareholding in Xiamen Shipbuilding Industry Co., Ltd. This investment is stated at cost because there is no quoted market price available in an active market, nor any other alternative method available that can reasonably estimate the fair value of the investment.

There were no disposal or impairment provisions on available-for-sale financial asset in 2006.

9 DEFERRED INCOME TAX ASSETS

Deferred income tax assets were calculated in full on temporary differences under the liability method using a principal tax rate of 15% (2005: 15%).

Deferred income tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets against current income tax liabilities and when the deferred income taxes related to the same fiscal authority. The amounts of deferred income tax assets are as follows:

	2006 Rmb'000	2005 Rmb'000
Deferred income tax assets:		
— Deferred income tax assets to be recovered after more than 12 months	**2,938**	2,493
— Deferred income tax assets to be recovered within 12 months	**—**	—
	2,938	2,493

The movement on the deferred income tax assets is as follows:

	2006 Rmb'000	2005 Rmb'000
Beginning of the year	**2,493**	9,775
Charged to the income statement *(Note 23)*	**445**	(7,282)
End of the year	**2,938**	2,493

9 DEFERRED INCOME TAX ASSETS *(Continued)*

The components of deferred income tax assets during the year are as follows:

	Beginning of the year *Rmb'000*	(Charged)/ credited to the income statement *Rmb'000*	End of the year *Rmb'000*
Deferred income tax assets:			
Year ended 31 December 2005			
— Provisions for impairments of receivables and inventories	1,545	(569)	976
— Provision for impairment of property, plant and equipment	1,517	—	1,517
— Loss on disposals of property, plant and equipment	4,883	(4,883)	—
— Loss on write off of inventories	1,830	(1,830)	—
	9,775	(7,282)	2,493
Year ended 31 December 2006			
— Provisions for impairments of receivables and inventories	976	445	1,421
— Provision for impairment of property, plant and equipment	1,517	—	1,517
	2,493	445	2,938

The above deferred income tax assets arise in the following circumstances:

– Provisions for impairments of receivables, inventories and property, plant and equipment are not tax deductible until approved by the local tax authority;

– Loss on disposals of property, plant and equipment is not tax deductible until approved by the local tax authority; and

– Loss on write-off of inventories is not tax deductible until approved by the local tax authority.

Deferred income tax assets are recognised to the extent that the realisation of the related tax benefit through the future taxable profits is probable. As at 31 December 2006, the Company did not recognise deferred income tax assets of approximately Rmb32,451,000 (2005: Rmb34,539,000) in respect of provisions for impairments for receivables, inventories and property, plant and equipment that are not tax deductible.

10 INVENTORIES

	2006 ***Rmb'000***	2005 *Rmb'000*
Raw materials	**1,454,697**	1,163,846
Work in progress	**383,790**	270,768
Finished goods	**148,656**	222,059
Spare parts and consumables	**159,825**	192,668
	2,146,968	1,849,341

During the year ended 31 December 2006, the Company recognised a write-down of inventories of Rmb3,843,000 (2005: reversal of write-down of Rmb3,881,000) . The amount recognised has been included in cost of goods sold in the income statement (Note 20).

The cost of inventory recognised as expenses and included in cost of goods sold amounted to Rmb7,179,794,000 (2005: Rmb6,347,620,000).

11 TRADE AND OTHER RECEIVABLES

	2006 **Rmb'000**	2005 Rmb'000
Notes receivables	**315,426**	356,077
Accounts receivable *(Note (a))*	**258,685**	249,337
Trade receivables	**574,111**	605,414
Less: provision for impairment of trade receivables	**(150,948)**	(153,702)
Trade receivables - net	**423,163**	451,712
Receivables from fellow subsidiaries of the Holding Company *(Note (b) and 29(d))*	**116,818**	99,491
Less: provision for impairment of receivables from fellow subsidiaries of the Holding Company	**(10,079)**	(2,710)
Receivables from fellow subsidiaries of the Holding Company - net	**106,739**	96,781
Prepayments and deposits	**209,756**	145,204
Other receivables	**22,721**	25,440
Less: provision for impairment of other receivables *(Note (c))*	**(11,718)**	(10,659)
Other receivables - net	**11,003**	14,781
	750,661	708,478
Less non-current portion: prepayment to a supplier	**(62,600)**	(71,600)
Current portion	**688,061**	636,878

The fair values of trade and other receivables are as follows:

	2006 **Rmb'000**	2005 Rmb'000
Trade receivables	**423,163**	451,712
Receivables from fellow subsidiaries of the Holding Company	**106,739**	96,781
Prepayments and deposits	**209,756**	145,204
Other receivables	**11,003**	14,781
	750,661	708,478

The maturity of non-current prepayment to a supplier is as follows:

	2006 **Rmb'000**	2005 Rmb'000
Between 1 and 2 years	**9,600**	9,000
Between 2 and 5 years	**42,600**	41,400
Over 5 years	**10,400**	21,200
	62,600	71,600

11 TRADE AND OTHER RECEIVABLES *(Continued)*

(a) The Company normally requires advanced payments from new customers before delivery. For existing customers, the Company normally offers a 1-month credit period. The ageing analysis of accounts receivables as at 31 December 2006 is as follows:

	2006 **Rmb'000**	2005 *Rmb'000*
Within 3 months	**100,342**	89,614
Between 3 months and 1 year	**1,360**	3,498
Between 1 and 2 years	**5,308**	2,092
Between 2 and 3 years	**2,089**	2,257
Over 3 years	**149,586**	151,876
	258,685	249,337

There is no concentration of credit risk with respect to trade receivables, as the Company has a large number of customers, domestically dispersed.

Movements on the provision for impairment of trade receivables are as follows:

	2006 **Rmb'000**	2005 *Rmb'000*
At 1 January	**153,702**	157,832
Reversal of impairment of trade receivables	**(2,367)**	(2,705)
Receivables written off during the year as uncollectible	**(387)**	(1,425)
At 31 December	**150,948**	153,702

The amount reversed has been included in administrative expenses in the income statement (Note 20).

(b) The ageing analysis of receivables from fellow subsidiaries of the Holding Company as at 31 December 2006 is as follows:

	2006 **Rmb'000**	2005 *Rmb'000*
Within 3 months	**102,317**	50,172
Between 3 months and 1 year	**4,372**	33,627
Between 1 and 2 years	**34**	3,650
Between 2 and 3 years	**16**	9,332
Over 3 years	**10,079**	2,710
	116,818	99,491

During the year ended 31 December 2006, the Company recognised provision for impairment of the receivables from a fellow subsidiary of the Holding Company of Rmb7,369,000 (2005: Nil). The amount recognised has been included in administrative expenses in the income statement (Note 20).

(c) During the year ended 31 December 2005, the Company had received verdicts and enforcement orders from certain courts ("the Courts"), including the People's Courts of Neijiang, Sichuan Province of the PRC, in relation to certain debts owed by the Holding Company and Chongqing Special Steel (Group) Limited Company ("CSSG"; former subsidiary of the Holding Company which ceased to have shareholding relationship with the Holding Company since June 2003) to their creditors amounting to Rmb18,200,000 and Rmb18,340,000, respectively. According to these verdicts and enforcement orders, the Company was requested to withhold in aggregate Rmb36,540,000 dividend to be distributed to the Holding Company ("the Dividend"). The Company did not withhold the Dividend and without notifying the Company, two of the Courts had withdrawn Rmb4,528,000 and Rmb1,059,000 from the Company's bank accounts in 2005 and 2006 respectively.

11 TRADE AND OTHER RECEIVABLES *(Continued)*

(c) ***(Continued)***

In November 2006, as the Holding Company settled its debts amounting to Rmb18,200,000, the Courts withdrew those verdicts and enforcement orders against the Holding Company, and accordingly the Company was not required to assist the execution of the verdicts.

As at the date of these financial statements are approved for issue, the case relating to the debts of Rmb18,340,000 owed by CSSG has not been finalised. Based on the advice from the Company's legal counsel, management of the Company is of the view that the verdicts and the enforcement orders made by the Courts are without merit as CSSG is no longer associated with the Holding Company or the Company, and accordingly the Company has no obligation to assist the execution of the verdicts. The Company has made objections to the Courts and seek assistance and resolution from relevant higher courts, Municipal Governments and Standing Committee of the People's Congress.

As the recoverability of the withdrawn bank deposits (recorded as other receivable) is uncertain, management of the Company recorded an impairment provision of Rmb4,528,000 and Rmb1,059,000 as other gains/ losses for the years ended 31 December 2005 and 2006 respectively (Note 19).

12 RESTRICTED CASH

	2006 ***Rmb'000***	2005 *Rmb'000*
Restricted cash deposits for letter of credit	**26,126**	13,342
Restricted cash deposits for trade payables *(Note 16(a))*	**37,744**	—
	63,870	13,342

Restricted cash of Rmb55,930,000 (2005: Rmb85,000) are deposited in state-owned banks (Note 29(d)).

13 CASH AND CASH EQUIVALENTS

	2006 ***Rmb'000***	2005 *Rmb'000*
Cash in hand	**784**	799
Cash and short-term bank deposits	**312,988**	450,421
	313,772	451,220

The effective interest rate on short-term bank deposits was 1.06% (2005: 1.32%).

Short-term bank deposits of Rmb289,043,000 (2005: Rmb389,453,000) are deposited in state-owned banks (Note 29(d)).

14 SHARE CAPITAL

	Number of shares *('000)*	**State - owned shares** *RMB'000*	**H shares** *RMB'000*	**Total** *RMB'000*
Registered, issued and fully paid:				
At 1 January 2005 and 31 December 2005 (nominal value of RMB1.00 each)	1,063,944	650,000	413,944	1,063,944
Issue of new shares as bonus share dividend *(Note 25)*	319,183	195,000	124,183	319,183
At 31 December 2006 (nominal value of RMB1.00 each)	1,383,127	845,000	538,127	1,383,127

14 SHARE CAPITAL *(Continued)*

In February 2007, the Company issued 350,000,000 A shares to public investors, which were then listed on The Stock Exchange of Shanghai on 28 February 2007. The 845,000,000 State-owned shares held by the Holding Company has been automatically converted into 845,000,000 A shares after the issuance of the A shares. The Holding Company has undertaken that, within a period of 36 months from the date of the listing of the A shares, it will not transfer or nominate any other persons to manage its A shares and will not proceed with any re-purchase of such A shares by the Company.

The state-owned shares, H shares and A shares rank pari passu in all respects.

15 OTHER RESERVES

	Share premium *Rmb'000*	Capital surplus *Rmb'000* *Note (a)*	Statutory common reserve *Rmb'000* *Note (b)*	Statutory provident fund *Rmb'000* *Note (c)*	Total *Rmb'000*
At 1 January 2005	276,208	216,071	261,004	130,502	883,785
Transfer from retained earnings	—	—	25,957	12,978	38,935
At 31 December 2005	276,208	216,071	286,961	143,480	922,720
At 1 January 2006	276,208	216,071	286,961	143,480	922,720
Transfer statutory provident fund to statutory common reserve *(Note (c))*	—	—	143,480	(143,480)	—
Transfer from retained earnings *(Note (b))*	—	—	31,484	—	31,484
At 31 December 2006	276,208	216,071	461,925	—	954,204

(a) According to the Company's Articles of Association, the Company shall record the following as capital surplus: (i) donations; (ii) appreciation arising from revaluation of assets; and (iii) other items in accordance with the articles of association and relevant regulations in the PRC. Capital surplus may be utilised to make up losses or for the issuance of bonus shares.

(b) According to the Company's Articles of Association, the Company is required to transfer 10% of its net profit as stated in the statutory accounts prepared under the accounting standards in the PRC ("PRC GAAP") to statutory common reserve until the reserve reaches 50% of the registered capital. The transfer to this reserve must be made before the distribution of dividend to shareholders.

The statutory common reserve shall only be used to make up losses, to expand the Company's production operations, or to increase the capital of the Company. Upon approval by a resolution of shareholders' general meeting, the Company may convert its statutory common reserve into share capital and issue bonus shares to existing shareholders in proportion to their existing shareholdings or increase the nominal value of each share. After converting the Company's statutory common reserve into capital, the balance of such reserve must not be less than 25% of the registered capital.

For the year ended 31 December 2006, the board of directors of the Company proposed the transfer of 10% (2005: 10%) of the net profit as reported in the PRC statutory accounts to the statutory common reserve, totalling Rmb31,484,000 (2005: Rmb25,957,000). The resolution is subject to the approval by the shareholders at the Annual General Meeting.

(c) According to the original Company's Articles of Association, the Company was required to transfer 5% to 10% of its net profit as stated in the statutory accounts prepared under PRC GAAP to statutory provident fund. For the year ended 31 December 2005, 5% of the net profit as reported in the PRC statutory accounts was transferred to the statutory provident fund, totalling Rmb12,978,000.

According to the Company Law of PRC amended on 27 October 2005 and effective from 1 January 2006, and the Company's Articles of Association amended on 30 March 2006, the Company is not required to make appropriation to any statutory provident fund from 1 January 2006.

According to the " Circular on Accounting Treatment Following the Implementation of Company Law" issued by the Ministry of Finance of the PRC on 15 March 2006, the Company transferred the balance of statutory provident fund as at 31 December 2005 to statutory common reserve in 2006.

16 TRADE AND OTHER PAYABLES

	2006 Rmb'000	2005 Rmb'000
Trade payables *(Note (a))*	**1,183,647**	899,172
Advances from customers	**884,062**	562,600
Amounts due to the Holding Company and its subsidiaries *(Note 29(d))*	**57,678**	47,667
Value added tax and other tax payables	**54,047**	16,857
Salaries payable	**16,296**	30,003
Deposits from customers	**4,275**	12,565
Other payables	**44,668**	25,527
	2,244,673	1,594,391
Less non-current portion:		
— Advance from a customer *(Note(b))*	**(215,897)**	(117,748)
— Other payables	**(17,141)**	(8,396)
	(233,038)	(126,144)
	2,011,635	1,468,247

(a) The ageing analysis of trade payables as at 31 December is as follows:

	2006 Rmb'000	2005 Rmb'000
Within 6 months	**699,727**	687,168
Between 6 months and 1 year	**453,714**	189,514
Between 1 and 2 years	**8,908**	4,955
Between 2 and 3 years	**4,734**	1,744
Over 3 years	**16,564**	15,791
	1,183,647	899,172

As at 31 December 2006, bills payable amounting to Rmb110,000,000 included in trade payables were secured by bank deposits of Rmb37,744,000 (2005: Nil) (Note 12).

(b) The maturity of non-current advance from a customer is as follows:

	2006 Rmb'000	2005 Rmb'000
Between 1 and 2 years	**115,431**	117,748
Between 2 and 5 years	**100,466**	—
	215,897	117,748

The original effective interest rates on non-current advance from a customer received in 2005 and 2006 are 5.18% and 5.58% respectively.

17 BORROWINGS

	2006 **Rmb'000**	2005 Rmb'000
Non-current		
Secured bank borrowings *(Note (a))*	**220,000**	285,000
Unsecured bank borrowings *(Note (b))*	**75,000**	420,000
	295,000	705,000
Current		
Secured bank borrowings *(Note (a))*	**778,000**	594,000
Unsecured bank borrowings *(Note (b))*	**1,569,653**	1,312,810
	2,347,653	1,906,810
Total borrowings	**2,642,653**	2,611,810

(a) Bank borrowings of Rmb848,000,000 (2005: Rmb625,000,000) are secured by the Company's property, plant and equipment with net book amount of Rmb135,990,000 (2005: Rmb93,782,000) as at 31 December 2006 (Note 6) together with certain parcels of land use right owned by the Holding Company and certain property, plant and equipment owned by certain fellow subsidiaries of the Holding Company (Note 29(a)).

Bank borrowings of Rmb150,000,000 (2005: Rmb254,000,000) are secured by the Company's property, plant and equipment with net book amount of Rmb443,270,000 (2005: Rmb464,320,000) (Note 6) together with a parcel of land use right with net book amount of Rmb26,914,000 (2005: Rmb27,290,000) (Note 7) as at 31 December 2006 owned by the Company.

(b) Unsecured bank borrowings of Rmb1,415,000,000 (2005: Rmb1,336,900,000) are guaranteed by the Holding Company (Note 29(a)).

Bank borrowings of Rmb1,419,000,000 (2005: Rmb2,013,650,000) are borrowed from state-owned banks (Note 29(d)).

The maturity of borrowings is as follows:

	2006 **Rmb'000**	2005 Rmb'000
Within 1 year	**2,347,653**	1,906,810
Between 1 and 2 years	**295,000**	505,000
Between 2 and 5 years	**—**	200,000
	2,642,653	2,611,810

The effective interest rates per annum at the balance sheet dates were as follows:

	2006		2005	
	Rmb	**USD**	Rmb	USD
Bank borrowings	**2.88% to 7.13%**	**6.39% to 6.48%**	2.88% to 6.73%	5.56%

17 BORROWINGS *(Continued)*

The carrying amounts and fair values of the non-current borrowings are as follows:

	Carrying amounts		Fair values	
	2006	2005	**2006**	2005
	Rmb'000	*Rmb'000*	***Rmb'000***	*Rmb'000*
Bank borrowings	**295,000**	705,000	**296,089**	708,332

The fair values are based on cash flows discounted using rates based on the borrowings rates of 5.76% to 6.34% (2005: 5.76% to 6.34%).

The carrying amounts of current borrowings approximate their fair value.

The carrying amounts of the borrowings are denominated in the following currencies:

	2006	2005
	Rmb'000	*Rmb'000*
Rmb	**2,584,088**	2,369,650
Usd	**58,565**	242,160
	2,642,653	2,611,810

As at 31 December, the Company has the following undrawn borrowing facilities:

	2006	2005
	Rmb'000	*Rmb'000*
Fixed rate		
— expiring within one year	**201,000**	265,000
— expiring beyond one year	**—**	4,000
	201,000	269,000

The facilities expiring within one year are annual facilities subject to review at various dates during 2007. The other facilities have been arranged to help finance the operation of the Company.

18 DEFERRED INCOME

The movement of deferred income is as follows:

	2006	2005
	Rmb'000	*Rmb'000*
At 1 January	**10,154**	—
Additions	**71,154**	12,178
Credited to the income statement	**(4,004)**	(2,024)
At 31 December	**77,304**	10,154

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 State Tax Bureau, part of the purchase costs of the domestic manufactured equipment could be utilised to reduce the Company's enterprise income tax.

18 DEFERRED INCOME *(Continued)*

In accordance with the approvals issued by State Tax Bureau in Dadukou District, Chongqing, with respect to the application for income tax reduction lodged by the Company relating to the purchase of domestic manufactured equipment in 2005 and 2004, the Company is entitled to a tax reduction totalling of Rmb170,821,000, of which Rmb12,178,000 and Rmb52,394,000 were utilised to offset the Company's income tax liability for 2005 and 2006 respectively. The reduction of the Company's income tax liability were recorded as deferred income and are recognised as income on a straight-line basis over the expected lives of the related assets. The remaining of Rmb106,249,000 can be utilised to offset future enterprise income tax payments for not more than 5 years.

In accordance with the circulars (Yu Cai Jian [2006] No.326 and No.549) issued by the Environmental Protection Administration of Chongqing in 2006, the Company was exempted from repayment of loans of Rmb18,760,000 relating to the construction of environmental protection equipment and facilities. The exemption was recorded as deferred income and is to be recognised as income on a straight-line basis over the expected lives of the related assets.

19 OTHER GAINS - NET

	2006 ***Rmb'000***	2005 *Rmb'000*
Profit on sale of by-products, net	**5,197**	3,253
Operating lease rental income	**1,261**	1,212
Utility installation service income	**1,883**	4,414
Interest income *(Note (a))*	**4,435**	9,385
Loss on disposals of property, plant and equipment	**(3,992)**	(8,839)
Provision of impairment for other receivables *(Note 11(c))*	**(1,059)**	(4,528)
Bank charges	**(673)**	(1,737)
Others	**1,985**	3,303
	9,037	6,463

(a) Interest income of Rmb2,644,000 (2005: Rmb8,845,000) is generated from cash and short-term bank deposits in state-owned banks (Note 29(b)).

20 EXPENSES BY NATURE

Expenses included in cost of goods sold, selling and marketing costs and administrative expenses are analysed as follows:

	2006 ***Rmb'000***	2005 *Rmb'000*
Depreciation *(Note 6)*	**264,895**	215,750
Amortisation *(Note 7)*	**376**	376
Provision for/(written-back of) impairment of receivables *(Note 11)*	**5,002**	(2,705)
Employee benefit expense *(Note 21)*	**610,507**	578,401
Changes in inventories of finished goods and work in progress	**(33,704)**	(57,594)
Raw materials and consumables used	**7,209,655**	6,409,095
Write-down/(reversal of write-down) of inventories *(Note 10)*	**3,843**	(3,881)
Auditors' remuneration	**2,631**	2,680
Maintenance expenses	**345,513**	342,798
Rental for land use rights *(Note 29(b))*	**16,286**	14,521
Transportation expenses	**92,799**	67,414
Plate inspection fees	**45,388**	33,072
Other expenses	**576,151**	854,898
	9,139,342	8,454,825

21 EMPLOYEE BENEFIT EXPENSE

	2006 *Rmb'000*	2005 *Rmb'000*
Salaries	405,980	389,622
Retirement benefit costs - defined contribution plans	79,821	76,191
Other social welfare costs	124,706	112,588
	610,507	578,401

(a) Directors' and supervisors' emoluments

The remuneration of every director and supervisor for the year ended 31 December 2006 is set out below:

Name of director and supervisor	Fees *Rmb'000*	Basic salaries, housing allowances and other allowances *Rmb'000*	Bonuses *Rmb'000*	Pension *Rmb'000*	Total *Rmb'000*
Director:					
Mr. Tang Min Wei (i)	—	8	42	2	52
Mr. Yang Zhi Wei (iii)	—	9	63	4	76
Mr. Luo Fu Qin	—	65	77	7	149
Mr. Yuan Jin Fu	—	97	113	10	220
Mr. Chen Shan	—	21	187	10	218
Mr. Sun Yi Jie	—	20	157	10	187
Mr. Tu De Ling	—	19	157	10	186
Mr. Chen Hong (v)	—	11	72	10	93
Mr. Wang Xiang Fei	—	60	—	—	60
Mr. Wu Zhong Fu (ii)	—	—	—	—	—
Mr. Liu Xing (iv)	—	40	—	—	40
Mr. Sun Yu	—	40	—	—	40
Supervisor:					
Mr. Zhu Jian Pai	—	97	116	10	223
Mr. Huang You He	—	19	93	10	122
Ms. Yuan Xue Bin	—	17	82	10	109
Ms. Chen Hong	—	16	81	10	107
Ms. Lu Kang Mei	—	18	105	10	133
	—	557	1,345	113	2,015

21 EMPLOYEE BENEFIT EXPENSE *(Continued)*

(a) Directors' and supervisors' emoluments *(Continued)*

The remuneration of every director and supervisor for the year ended 31 December 2005 is set out below:

Name of director and supervisor	Fees Rmb'000	Basic salaries, housing allowances and other allowances Rmb'000	Bonuses Rmb'000	Pension Rmb'000	Total Rmb'000
Director:					
Mr. Tang Min Wei (i)	—	28	145	9	182
Mr. Yang Zhi Wei (iii)	—	20	137	9	166
Mr. Yuan Jin Fu	—	20	134	9	163
Mr. Chen Shan	—	21	135	9	165
Mr. Sun Yi Jie	—	20	123	9	152
Mr. Tu De Ling	—	20	123	9	152
Mr. Wang Xiang Fei	—	60	—	—	60
Mr. Wu Zhong Fu (ii)	—	30	—	—	30
Mr. Sun Yu	—	30	—	—	30
Supervisor:					
Mr. Zhu Jian Pai	—	20	136	9	165
Mr. Huang You He	—	18	77	9	104
Ms. Yuan Xue Bin	—	16	70	9	95
Ms. Chen Hong	—	15	73	9	97
Ms. Lu Kang Mei	—	17	75	9	101
	—	335	1,228	99	1,662

(i) Resigned on 26 April 2006.

(ii) Resigned on 9 June 2006.

(iii) Resigned on 20 September 2006 .

(iv) Appointed on 9 June 2006.

(v) Appointed on 20 September 2006.

The emoluments fell within the following band:

	Number of directors and supervisors 2006	2005
Emoluments band Nil-HK$1,000,000	**17**	14

No directors and supervisors waived their emoluments and no emoluments were paid or payable by the Company to any directors and supervisors as inducement to join or as compensation for loss of office in respect of the year ended 31 December 2006 (2005: Nil).

(b) Five highest paid individuals

The five individuals whose emoluments were the highest in the Company for the years ended 31 December 2006 and 2005 were directors or supervisors and their emoluments are reflected in the analysis presented above.

22 FINANCE COSTS

	2006 Rmb'000	2005 Rmb'000
Interest expense on bank borrowings wholly repayable within 5 years	**173,507**	127,944
Interest expense on trade and other payables	**17,074**	7,463
Net foreign exchange transaction gains	**(6,571)**	(3,287)
	184,010	132,120

Interest expense of Rmb128,833,000 (2005: Rmb95,668,000) is paid/payable for borrowings from state-owned banks (Note 29(b)).

23 INCOME TAX EXPENSE

	2006 Rmb'000	2005 Rmb'000
Current PRC income tax	**53,932**	37,559
Deferred income tax *(Note 9)*	**(445)**	7,282
	53,487	44,841

The taxation on the Company's profit before income tax differs from the theoretical amount that would arise using the taxation rate of the Company as follows:

	2006 Rmb'000	2005 Rmb'000
Profit before taxation	**307,582**	275,644
Calculated at taxation rate of 15% *(Note (a))*	**46,137**	41,347
Utilisation of previously unrecognised temporary differences	**(1,554)**	(3,064)
Effect of different tax rates applied for the periods in which the temporary differences are expected to reverse	**—**	4,736
Expenses not deductible for/income not subject to taxation	**8,904**	1,822
	53,487	44,841

(a) 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 approvals (Yu Guo Shui Han [2003] No. 57 and Da Dukou Guo Shui Han [2003] No. 8) issued by the relevant tax authorities under which the preferential enterprise income tax treatment for enterprises in the western development region is granted to the Company. 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 enterprise income tax rate is reduced to 15% for the period from 2001 to 2010. As approved by the tax authority, the Company is exempted from local income tax in 2006 (2005: Nil).

No Hong Kong profits tax has been provided as the Company had no taxable profits in Hong Kong for the year (2005: Nil).

24 EARNINGS PER SHARE

Basic earnings per share is calculated by dividing the profit attributable to the equity holders of the Company of Rmb254,095,000 (2005: Rmb230,803,000) by the weighted average number of ordinary shares in issue during the year of 1,383,127,000 shares (2005: 1,383,127,000 shares). In determining the weighted average number of ordinary shares in issue for the years ended 31 December 2005 and 2006, the 319,183,000 bonus shares (Note 25) issued in 2006 were treated as if it had occurred prior to 1 January 2005, the earliest period presented.

Diluted earnings per share equals to basic earnings per share as there are no potential dilutive shares outstanding as at 31 December 2006 (2005: Nil).

25 DIVIDENDS

In accordance with the relevant regulations of the PRC and the Company's Articles of Association, the Company declares dividends based on the lower of the retained earnings as reported in the PRC statutory accounts and financial statements prepared in accordance with HKFRS. As the statutory accounts have been prepared in accordance with PRC GAAP, the retained earnings as reported in the statutory accounts will be different from the amount reported in these financial statements.

During the general meeting of shareholders on 9 June 2006, it was resolved to declare dividends in respect of 2005 of Rmb0.15 per share (2004: Rmb0.15 per share), totalling Rmb159,592,000 (2004: Rmb159,592,000), and a bonus share dividend of 3 (2004: Nil) shares per 10 shares, totalling of 319,183,000 shares (2004: Nil). The allocation basis of the dividends being distributed to the shareholders was based on the number of shares in issue of 1,063,944,000 as at 31 December 2005.

During the Board of Directors' meeting on 30 August 2006, the directors of the Company resolved to declare an interim dividend for 2006 of Rmb0.08 per share, totalling Rmb110,650,000, which was authorized by the general meeting of shareholders on 9 June 2006. The allocation basis of the dividends being distributed to the shareholders was based on the number of shares in issue of 1,383,127,000 as at 30 June 2006.

A dividend in respect of 2006 of Rmb0.10 per share, amounting to a total dividend of Rmb173,313,000, is to be proposed at the forthcoming Annual General Meeting. The allocation basis of the dividends being distributed to the shareholders was based on the number of shares in issue of 1,733,127,000 as at 28 February 2007, including 350,000,000 A shares issued by the Company in 2007, as the extraordinary general meeting of shareholders held on 16 April 2003 had resolved that the retained earnings before the issuance of A shares be shared by all the shareholders, including the A shares shareholders, after the issuance of the A shares. The financial statements of 2006 do not reflect this dividend payable.

	2006 ***Rmb'000***	2005 *Rmb'000*
Final, proposed, of Rmb0.10 (2005: Rmb0.15) per share	**173,313**	159,592

26 CASH GENERATED FROM OPERATIONS

	2006 ***Rmb'000***	2005 *Rmb'000*
Profit for the year	**254,095**	230,803
Adjustments for:		
— Taxation *(Note 23)*	**53,487**	44,841
— Depreciation and amortisation *(Notes 6 and 7)*	**265,271**	216,126
— Provision for impairment of receivables *(Note 11)*	**6,061**	1,823
— Write-down/(reversal of write-down) of inventories *(Note 10)*	**3,843**	(3,881)
— Loss on disposals of property, plant and equipment *(Note (a))*	**3,992**	8,839
— Finance costs *(Note 22)*	**184,010**	132,120
— Interest income *(Note 19)*	**(4,435)**	(9,385)
Changes in working capital:		
— Inventories	**(301,470)**	(304,194)
— Trade and other receivables	**(48,244)**	(93,641)
— Restricted cash *(Note 12)*	**(50,528)**	48,262
— Trade and other payables	**491,180**	26,886
Cash generated from operations	**857,262**	298,599

26 CASH GENERATED FROM OPERATIONS

(a) In the cash flow statement, proceeds from disposals of property, plant and equipment comprise:

	2006	2005
	Rmb'000	*Rmb'000*
Net book amount *(Note 6)*	**7,678**	29,233
Loss on disposals of property, plant and equipment *(Note 19)*	**(3,992)**	(8,839)
Proceeds from disposals of property, plant and equipment	**3,686**	20,394

27 CONTINGENT LIABILITIES

As at 31 December 2006, other than the pending litigation as described in Note 11(c), the Company had no material contingent liabilities.

28 COMMITMENTS

(a) Capital commitments for property, plant and equipment

	2006	2005
	Rmb'000	*Rmb'000*
Contracted but not provided for	**525,493**	525,956
Authorised but not contracted for	**301,145**	501,973
	826,638	1,027,929

(b) Operating lease commitments

As at 31 December, the future aggregate minimum lease payments under non-cancellable operating leases in respect of land and buildings are as follows:

	2006	2005
	Rmb'000	*Rmb'000*
Not later than 1 year	**17,904**	14,913
Later than 1 year and not later than 5 years	**65,796**	58,186
Later than 5 years	**90,463**	95,597
	174,163	168,696

Included in the above operating lease commitments are commitments in respect of the leases of three parcels of land for a period of 20 years, 15 years and 3 years from the Holding Company commencing from August 1997, December 2002 and January 2006, respectively. According to the supplementary agreement between the Company and the Holding Company signed in January 2007, the annual rental of the first 2 abovementioned leases have been increased from 1 January 2007. As at 31 December 2006, the future aggregate minimum lease payments under such operating leases amounted to Rmb157,013,000 (2005: Rmb155,095,000), Rmb13,270,000 (2005: Rmb13,107,000) and Rmb3,880,000 (2005: Nil) respectively.

29 RELATED PARTY TRANSACTIONS

The Company is controlled by the Holding Company (incorporated in the PRC), which owns 61% of the Company's shares. The directors of the Company considered the Holding Company to be the ultimate parent company.

Given that the PRC government still owns a significant portion of the productive assets in the PRC despite the continuous reform of the government structure, the majority of the Company's business activities had been conducted with enterprises directly or indirectly owned or controlled by the PRC government ("state-owned enterprises"), including the Holding Company, its subsidiaries, associated companies and jointly controlled entities in the ordinary course of business. In accordance with the revised HKAS 24, "Related Party Disclosures" ("HKAS 24"), state-owned enterprises and their subsidiaries, other than entities under the Holding Company, directly or indirectly controlled by the PRC government are also defined as related parties of the Company.

The following transactions were carried out with related parties:

(a) The Company's bank borrowings of Rmb848,000,000 (2005: Rmb625,000,000) as at 31 December 2006 are secured by certain land use right of the Holding Company together with certain property, plant and equipment of the Company (Note 17(a)).

Included in abovementioned bank borrowings as at 31 December 2006, bank borrowings of Rmb99,000,000 (2005: Nil) which are also secured by certain property, plant and equipment of certain fellow subsidiaries of the Holding Company.

In addition, as at 31 December 2006 the Company's bank borrowings of Rmb1,415,000,000 (2005: Rmb1,336,900,000) are guaranteed by the Holding Company (Note 17(b)).

(b) Other than the transactions described above, the following is a summary of the significant transactions entered into by the Company on normal commercial terms with the Holding Company, fellow subsidiaries and other state-owned enterprises/banks during the year:

	2006 **_Rmb'000_**	2005 _Rmb'000_
Income		
Sales to fellow subsidiaries of the Holding Company *(Note (i))*	**753,096**	905,615
Sales to other state-owned enterprises *(Note (x))*	**3,113,915**	3,080,723
Fees received for supporting services *(Note (ii))*	**2,746**	2,646
Fees received for lease rental *(Note (iii))*	**1,101**	472
Interest income from state-owned banks *(Note 19 and Note (x))*	**2,644**	8,845
Expenditure		
Fees paid for supporting services *(Note (iv))*	**263,353**	335,181
Fees paid for lease rental *(Note (v))*	**541**	—
Purchase of raw materials and spare parts *(Note (vi))*	**1,354,130**	1,168,343
Purchase of property, plant and equipment *(Note (vii))*	**79,197**	55,686
Rental for land use rights *(Note (viii))*	**16,286**	14,521
Social welfare expenses paid through the Holding Company to schemes administered by the PRC government *(Note (ix))*	**71,645**	43,301
Staff welfare expenses and supplementary retirement benefit contribution paid to defined contribution retirement schemes administered by the Holding Company	**9,704**	32,686
Purchase from other state-owned enterprises *(Note (x))*	**2,573,017**	2,685,577
Interest paid/payable to state-owned banks *(Note 22 and Note (x))*	**128,833**	95,668
Borrowings from state-owned banks *(Note (x))*	**1,419,000**	1,708,900

29 RELATED PARTY TRANSACTIONS *(Continued)*

(b) *(Continued)*

(i) Sales to the fellow subsidiaries were made at prices determined by reference to those charged to other third party customers of the Company or the prices as prescribed by the relevant Chongqing government departments.

(ii) Fees received for supporting services mainly represent fees charged to the fellow subsidiaries for internal railway transportation services at prices determined by reference to a profit mark-up above the cost of providing such services as agreed between the Company and the fellow subsidiaries.

(iii) Fees received for lease rental mainly represents fee charged to the fellow subsidiaries for the lease of the Company's factory premises at price determined by reference to a mark-up for maintenance over and above the cost of depreciation of the factory premises.

(iv) Fees paid for supporting services mainly represent fees charged for environmental, maintenance, technical, installation and transportation services provided by the fellow subsidiaries. These services were charged at prices determined by reference to transactions of a similar nature contracted with other third party customers of the fellow subsidiaries or a profit mark-up above the cost of providing such services as agreed between the Company and the fellow subsidiaries, or prices prescribed by the relevant Chongqing government departments.

(v) Fees paid for lease rental mainly represents fee paid to the fellow subsidiaries for the lease of the subsidiaries' factory premises at price determined by reference to a mark-up for maintenance over and above the cost of depreciation of the factory premises.

(vi) Purchase of raw materials and spare parts was made at prices determined by reference to transactions of a similar nature contracted with other third party customers of the fellow subsidiaries or a profit mark-up above the cost of providing such products as agreed between the Company and the fellow subsidiaries, or the prices offered by suppliers of such spare parts.

(vii) Purchase of property, plant and equipment was made at prices determined by reference to the prices offered by suppliers of such equipment.

(viii) Rental expenses payable to the Holding Company are in accordance with the lease agreements entered into between the Company and the Holding Company.

(ix) For social welfare expenses which were paid through the Holding Company, no handling fee was charged by the Holding Company.

(x) Related party transactions with other state-owned enterprises/banks were conducted in the normal course of business at normal commercial terms

(c) Key management compensation

	2006 ***Rmb'000***	2005 *Rmb'000*
Salaries and other short-term employee benefits *(Note 21(a))*	**2,015**	1,662

29 RELATED PARTY TRANSACTIONS *(Continued)*

(d) Year-end balances arising from sales/purchases of goods/services and other transactions

	2006 **Rmb'000**	2005 Rmb'000
Short-term bank deposits in state-owned banks *(Note 13)*	**289,043**	389,453
Restricted cash in state-owned banks *(Note 12)*	**55,930**	85
Receivables due from related parties		
— Fellow subsidiaries of the Holding Company *(Note 11)*	**116,818**	99,491
— Trade and other receivables from other state-owned enterprises	**280,733**	222,498
	397,551	321,989
Trade and other payables due to related parties		
— The Holding Company *(Note 16)*	**38,458**	21,269
— Fellow subsidiaries of the Holding Company *(Note 16)*	**19,220**	26,398
— Trade and other payables to other state-owned enterprises	**454,282**	227,049
	511,960	274,716
Bank borrowings from state-owned banks *(Note 17)*	**1,419,000**	2,013,650

The amounts due from/to the Holding Company and fellow subsidiaries are unsecured, interest-free and have no fixed terms of repayment.

30 EVENTS AFTER THE BALANCE SHEET DATE

(a) In February 2007, the Company issued 350,000,000 A shares at Rmb2.88 each to public investors, and raised total gross proceeds of Rmb1,008,000,000. The Company's A shares were then listed on The Stock Exchange of Shanghai on 28 February 2007.

(b) On 16 March 2007, the National People's Congress approved the Corporate Income Tax Law of the People's Republic of China (the "new CIT Law"), which is effective from 1 January 2008.

Since the deferred tax assets shall be measured at the tax rates that are expected to apply to the period when the asset is realized, the change in the applicable tax rate will affect the determination of the carrying values of deferred tax assets of the Company. As at the date that these financial statements are approved for issue, detailed measures of the new CIT Law have yet to be issued, specific provisions concerning the applicable income tax rates, computation of taxable income, as well as specific preferential tax treatments and their related transitional provisions for the periods from 2008 and onwards have not been clarified. Consequently, the Company is not in a position to reasonably assess the impact, if any, to the carrying values of deferred tax assets as the result of the implementation of the new CIT Law. The Company will further evaluate the impact to its operating results and financial positions of future periods as more detailed measures and other related regulations are announced.