



# **Annual Report 2006**



## A Letter to the Investors

2006 is a year of stable and rapid growth for both the global and domestic economy. With sensible regulations from the state's macroeconomic policies, domestic economy has enjoyed another period of steady and fast development, with a GDP growth rate of 10.7%. Despite the steady rise in prices of steel, fuel and raw materials, the Company has successfully fulfilled all its production goals and set targets, thanks to efforts undertaken to optimize integration synergy, accelerate projects-in-progress, implement quality product strategy, and reduce cost while striving to improve efficiency. The Company's sales volume, revenue and profit all hit a new record high: the sales volume of finished steel products totaled 21.40 million tons, a 13.95% increase as against the previous year; sales revenue totaled Rmb 157.79 billion, which presented a 24.63% YoY rise; pre-tax profit reached Rmb 19.01 billion, a 3.8% rise as against the previous year, and net profit amounted to Rmb 13.01 billion, a 2.72% YoY rise.

In addition to unprecedented business performance, the company has made significant achievements in research, environmental protection and management.

The "Research on the Variety, Production, and Application Techniques of Baosteel High-grade Auto Sheets" was awarded the first prize of National Science & Technology Progress Award at the National Conference of Science and Technology, and Baosteel Stainless Project won the "Luban Prize" of 2005 civil engineering by the Ministry of Construction of China, the only one granted to domestic steel industry.

The Company ranks first among the "Enterprise with the strongest sense of social responsibility in 2005", a list prepared by China News Weekly on the basis of an overall evaluation of the enterprises' competitiveness, credit, law-abidingness, humanistic concerns, environmental protection, and social commitments. It also entered the list of "National Environment Friendly Enterprises", the sole winner of such an honor in the steel industry.

It topped the list of "2006 China's Top 10 Influential Brands in the World" and that of "2006 China's Top 10 Brands (Steel) in the World Market" in October. Standard & Poor's upgraded the Company's long-term credit rating from BBB+ to A-/Stable in December, which indisputably demonstrates its strong market potential and rapid business expansion.

As China's economy is expected to maintain its robust growth momentum in 2007, there will continue to be structural shortage in steel supply. Production capacities will be utilized at a reduced rate as the Government is now better prepared to close down backward production facilities. Meanwhile, macroeconomic policy regulation and price surges of raw materials will add to factors of uncertainties. Baosteel will continue to strive for world class products and services, greater creative initiatives, more immediate customer response, better farseeing long-term strategic planning on the part of its management as well as stronger financial performance in order to enhance its comprehensive competitiveness. The Company will further improve the integrated operation of its core steel industries for greater synergistic effects, optimize its product structure, quickly upgrade its independent innovation capabilities, promote environment friendly production, develop recycling economy, and nurture its corporate culture to enhance its strategic operation.

Baosteel is ready to embark onto its next phase of growth. As approved by the 5th Meeting of the Third Board of Directors, the steel production capacity of the Company is expected to reach 50 million tons by the year 2012, with much better profit-gaining performance. The company will establish steel production bases orientated towards high-end steel products and featured by complete product varieties, specifications and spare parts series to upgrade the overall competitiveness of its target products. With a keener sense of mission and responsibility, the Company strives to achieve new strategic development, tap its potential for further growth, increase its competitiveness both at home and abroad and strengthen its influence on steel sector. Baosteel is committed to enhance its viability as the leading player in the country.

All efforts will be made to ensure that Baosteel will keep developing along with the lines of scientific development, new industrialization mode and sustained long-term healthy enterprise growth and keep creating greater benefits for the shareholders, the customers, the employees, the suppliers and the community.



## Important Notice

The Board of Directors and the Board of Supervisors of Baoshan Iron & Steel Co., Ltd. (hereinafter referred to as the Company), along with their directors, supervisors and senior management, hereby warrant that there is no misrepresentation nor misleading expression obtained or deliberate omission in this Annual Report, and severally and jointly accept full responsibility for the truthfulness, accuracy and completeness of the information presented in this report.

Mr. Xu Lejiang, Chairman of the Board of Directors, Ms. Chen Ying, Financial Controller of the Company, and Mr. Wang Mingdong, Director of the Finance Department of the Company, attest to the truthfulness and accuracy of the financial statements contained in this report.

## Table of Contents

○	Important Notice	001
○	I. Company Profile	002
○	II. Financial Highlights	003
○	III. Capital and Shareholders	005
○	IV. Directors, Supervisors, Senior Managers and Employees	008
○	V. Corporate Governance	012
○	VI. Shareholders' Meetings	014
○	VII. Board of Directors' Report	015
○	VIII. Board of Supervisors' Report	034
○	IX. Significant Events	036
○	X. 2006 Audited Financial Statements	045
○	XI. Reference	142

## I. Company Profile

1. Chinese Name: 宝山钢铁股份有限公司  
Chinese Abbreviation: 宝钢股份  
English Name: Baoshan Iron & Steel Co., Ltd.  
English Abbreviation: Baosteel
2. Legal Representative: Xu Lejiang
3. Secretary to Board of Directors: Chen Ying  
BOD Representative of Securities Affairs: Yu Hong  
Address: Board of Directors' Office, Baoshan Iron & Steel Co., Ltd., South Building, Baoshan Hotel, 1813 Mudanjiang Road, Baoshan District, Shanghai  
Zip Code: 201900  
Tel: 86-21-26647000  
Fax: 86-21-26646999  
Email: [ir@baosteel.com](mailto:ir@baosteel.com)
4. Registered Address: South Building, 1813 Mudanjiang Road, Baoshan District, Shanghai  
Office Address: South Building, Baoshan Hotel, 1813 Mudanjiang Road, Baoshan District, Shanghai  
Zip Code: 201900  
Website: <http://www.baosteel.com>  
Email: [ir@baosteel.com](mailto:ir@baosteel.com)
5. Company Announcements or Disclosures published in *China Securities News*, *Shanghai Securities News*, and *Securities Times*  
Annual Report Website: <http://www.sse.com.cn>  
Copies of the Annual Report can be obtained from Board of Directors' Office, Baoshan Iron & Steel Co., Ltd., South Building, Baoshan Hotel, 1813 Mudanjiang Road, Baoshan District, Shanghai
6. Stock Listed at: Shanghai Stock Exchange  
Stock Name: 宝钢股份  
Stock Code: 600019
7. Date of Incorporation: February 3, 2000  
Place of Incorporation: Guoyuan, Fujin Road, Baoshan District, Shanghai  
Date of Change of Registration: June 1, 2006  
Corporate Business License Number: 3100001006333  
Tax Identification Number: 310041631696382  
Accounting Firm: Ernst & Young Hua Ming  
Address of Accounting Firm: F16, Unit E3, Economics & Trade Tower, Oriental Plaza, 1 East Changan Avenue, Dongcheng District, Beijing, China

## II. Financial Highlights

### 1. Financial Data

(Unit: Rmb million)

Item	Amount
Pre-tax profit	19,008
Net profit	13,010
Net profit excluding non-recurring gains and losses	13,247
Gross profit from principal businesses	27,893
Gross profit from other businesses	24
Operating profit	18,984
Investment income	325
Subsidies income	45
Net non-operating income and expenses	-346
Net cash flow from operating activities	21,596
Net increase in cash and cash equivalents	480

Non-recurring gains and losses

(Unit: Rmb million)

Item	Amount
Short-term investment income	96
Subsidies income	45
Loss from long-term equity investment	-145
Non-operating income and expenses	-346
Provision for non-operating expenses	3
Impact from income taxes	110
Total of non-recurring gains and losses	-237

## II. Financial Highlights

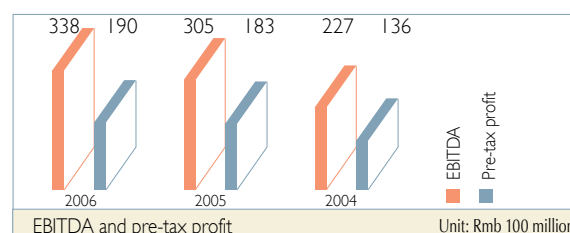
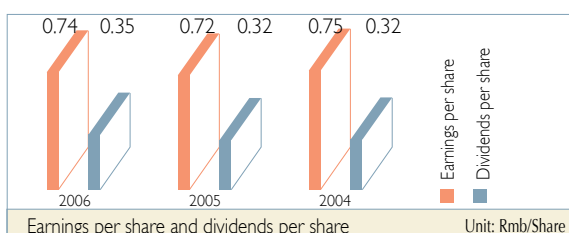
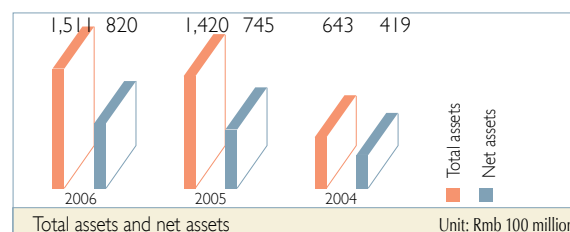
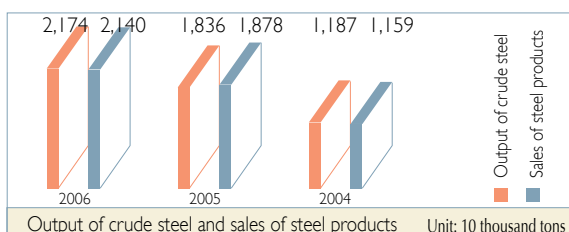
### 2. Summary of Three-year Financial and Operating Data

(Unit: Rmb million)

Item	2006	2005	2004
Revenues from principal businesses	157,791	126,608	58,638
Pre-tax profits	19,008	18,311	13,586
Net Profit	13,010	12,666	9,395
Net profit excluding non-recurring gains and losses	13,247	12,743	9,352
Earnings per share (Rmb)	0.74	0.72	0.75
Net cash flow per share (Rmb)	1.23	1.30	1.34
Return on equity (%) (fully-diluted)	15.87	17.01	22.44
Return on equity (%) (weighted average)	16.84	20.63	24.67
Return on equity excluding non-recurring gains and losses (%) (fully diluted)	16.16	17.11	22.34
Return on equity excluding non-recurring gains and losses (%) (weighted average)	17.15	20.75	24.56

(Unit: Rmb million)

Item	By end of 2006	By end of 2005	By end of 2004
Total assets	151,060	142,024	64,255
Shareholders' equity (excluding minority interest)	81,961	74,475	41,861
Net asset per share (Rmb)	4.68	4.25	3.35
Fully adjusted net asset per share (Rmb)	4.65	4.21	3.33



- Notes:
1. Earnings per share in the chart are the diluted amounts.
  2. The Board of Directors has already agreed upon an Rmb0.35 cash dividend per share for the year 2006, which is subject to approval at 2006 shareholders' general meeting.

### 3. Changes in Shareholders' Equity

(Unit: Rmb million)

Item	Capital	Capital surplus	Earning reserves	Retained earnings	Foreign currency translation difference	Total shareholders' equity
Beginning of year	17,512	32,723	11,697	12,591	-48	74,475
Increase		178	3,062	13,010	-2	16,248
Decrease		97		8,665		8,762
End of year	17,512	32,804	14,759	16,936	-50	81,961

### III. Capital and Shareholders

#### 1. Changes in capital

(Unit: 100 million shares)

	Beginning of year		Changes during the period (+, -)					End of year	
	Number of shares	Percentage	Baosteel Group increased shareholdings	Execution of Baosteel JTB1 warrants	Expiry of lockup period	Others	Subtotal	Number of shares	Percentage
I. Shares subject to conditional sales									
1. Government	136.41	77.89%	0.80	-0.06	-9.38		-8.64	127.77	72.96%
2. Domestic state-owned institutions									
3. Other domestic investors									
Including:									
Domestic institutions									
Domestic individual investors									
4. Foreign investors									
Including:									
Foreign institutions									
Foreign individual investors									
II. Shares not subject to conditional sales									
1. Rmb common shares	38.71	22.11%	-0.80	0.06	9.38		8.64	47.35	27.04%
2. Domestic listed foreign investment shares									
3. Overseas listed foreign investment shares									
4. Others									
III. Total	175.12	100%	0	0	0		0	175.12	100%

#### 2. Share issuing and listing

Following the approval by the China Securities Regulatory Commission (CSRC), as provided in the approval document No. [2005]15, on 27th April 2005, the Company issued five billion new shares at an offering price of Rmb 5.12 per share, including three billion state-owned shares placed to Baosteel Group and two billion placed to the public investors. The 1,649,857,731 shares of preemptive rights offering to existing shareholders were listed on May 9, 2005 at Shanghai Stock Exchange. As indicated in the public subscription notice, the off-line offerings of 350,142,269 shares to institutional investors on the pro-rata basis bear lock-up periods: the 7,986,000 shares to C-type investors, with a lock-up period of a month, were listed at Shanghai Stock Exchange on June 9, 2005; the 299,036,269 shares to B-type investors, with a lock-up period of two months, and the 43,120,000 shares to A-type investors, which bear a three-month lock-up period, were listed at Shanghai Stock Exchange on July 11 and August 18, 2005, respectively.

In accordance with the reform program approved on the 2005 First Interim Shareholders' Meeting held on 12th August 2005 and enacted on 18th August 2005, Baosteel Group made tradable its shares in the consideration of a payment to the tradable shareholders. The non-tradable shares of Baosteel Group obtained trading rights when consideration were paid to the accounts of the tradable shareholders. After the implementation of the program, the total capital stock of the Company remains to be 17,512,000,000. Due to the reform program, Baosteel Group issued 387,700,000 call warrants as consideration to existing tradable shareholders. The warrant as abbreviation is "Baosteel JTB1" with trade stock code 580000, listed at Shanghai Stock Exchange on August 22, 2005. On August 30, 2006, altogether 5,542,559 Baosteel JTB1 warrants were exercised and 5,542,559 shares were transferred from the account of Baosteel Group to the holders of the warrants. The shares began to be traded on August 31, 2006, and the total shares of the Company remained unchanged. The listing of Baosteel JTB1 was terminated and delisted at Shanghai Stock Exchange on September 4, 2006.

### III. Capital and Shareholders

## 3. Shareholders

### 3.1 Shareholders and Shareholdings

Unit: Share

Number of shareholders	117,928
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#### Top 10 shareholders

Name	Type of investor	Increase/ Decrease (+,-)	Total shares	Percent- age	Shares subject to conditional sales	Shares pledged or frozen
Baosteel Group Corp.	State-owned	74,054,032	13,714,863,571	78.32%	12,776,517,441	None
Ping An Insurance Company of China Ltd.—traditional-common insurance products	Others	140,339,473	214,664,605	1.23%	0	Unknown
Chinalife Insurance Company Ltd.—Dividends—Personal Insurance—005L—FH002	Others	116,067,324	136,067,324	0.78%	0	Unknown
Citigroup Global Markets Limited	Foreign shareholder	45,062,177	114,082,872	0.65%	0	Unknown
Chinalife Insurance (Group) Company Ltd.—traditional-common insurance products	Others	74,282,304	94,782,304	0.54%	0	Unknown
JP Morgan Chase Bank, National Association	Foreign shareholder	49,286,547	69,582,483	0.40%	0	Unknown
Fenghe Value Securities Investment Fund	Others	66,862,375	67,162,375	0.38%	0	Unknown
Harvest Strategic Growth fund	Others	63,934,148	63,934,148	0.37%	0	Unknown
UBS Limited	Foreign shareholder	-46,019,000	61,392,221	0.35%	0	Unknown
Morgan Stanley & Co. International Limited	Foreign shareholder	6,178,925	61,299,941	0.35%	0	Unknown
Remarks on affiliation, alliance or collusion among the aforementioned top ten shareholders	1. Fenghe Value Securities Investment Fund and Harvest Strategic Growth Fund are funds managed by Harvest Fund Management Co., Ltd. 2. Chinalife Insurance Company Ltd. is a subsidiary of Chinalife Insurance (Group) Company Ltd.					

Note: The shares listed in the table are all Rmb common shares.

### 3.2 Trading dates of shares subject to conditional sales

Unit: Share

Date	New tradable shares after the conditional sales period expires	Balance of the shares subject to conditional sales	Balance of the shares not subject to conditional sales (Existing shares and new shares)	Notes
August 19, 2007	875,600,000	11,900,917,441	5,611,082,559	Within the 12 months after the 24-month non-trading period since Baosteel Group obtained trading right, the Group shall not trade more than 5% of the total shares and the trading price shall not less than Rmb 5.63 per share. Within three years from the date of obtaining trading rights, after the company's shares got the circulation right, the Group will not reduce its holdings in the Company to be less than 67%.
August 19, 2008	11,900,917,441	0	17,512,000,000	The same as above.

### 3.3 Holding Company and Controlling Shareholder

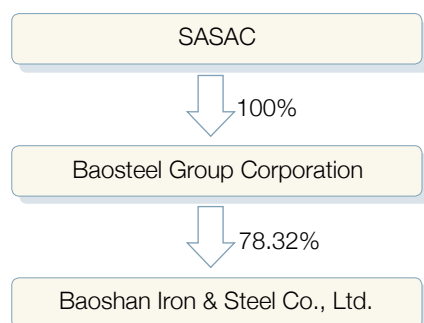
#### (1) Holding company

Name	Baosteel Group Corporation
Legal representative	Xie Qihua
Date of incorporation	November 17, 1998
Authorized capital	Rmb 45.8 billion
Principal businesses and operations	As a governmental authorized investment vehicle and a state-owned holding company, Baosteel Group Corporation mainly deals with state-owned assets within the authorized scope set by the State Council, involved in investments in areas as iron & steel manufacturing, metallurgy mining, non-toxic chemicals, electricity, piers, warehousing, transportation, and steel-related business, development and transfer of technologies, technical service and management consulting, imports and exports approved by the Ministry of Foreign Trade & Economic Cooperation (MOFTEC), domestic and international trading where allowed, and import and export services of products and technology.

#### (2) Controlling shareholder

Baosteel's ultimate controlling shareholder is the State-owned Assets Supervision and Administration Commission of the State Council (SASAC).

#### (3) Relationship between the Company and its controller



## IV. Directors, Supervisors, Senior Managers and Employees

### 1. Directors, Supervisors and Senior Managers

Name	Position	Gender	Age	Term of office	Compensation from shareholding company or affiliated companies
Xu Lejiang	Chairman of the Board of Directors	M	47	2006.05-2009.05	Yes
Ouyang Yingpeng	Vice Chairman of the Board of Directors	M	56	2006.05-2009.05	Yes
Ai Baojun	Director, President	M	46	2006.05-2009.05	No
Li Haiping	Director, Vice President	M	55	2006.05-2009.05	No
He Wenbo	Director	M	46	2006.05-2009.05	Yes
Wu Yaowen	Director	M	51	2006.05-2009.05	Yes
Laura Cha	Independent Director	F	57	2006.05-2009.05	No
Buck Pei	Independent Director	M	49	2006.05-2009.05	No
Katherine Tsang	Independent Director	F	49	2006.05-2009.05	No
Sun Haiming	Independent Director	M	50	2006.05-2009.05	No
Edward C. Tse	Independent Director	M	50	2006.05-2009.05	No
Li Li	Chairwoman of the Board of Supervisors	F	53	2006.05-2009.05	No
Zhou Zhuping	Supervisor	M	43	2006.05-2009.05	Yes
Zhong Yongqun	Supervisor	M	49	2006.05-2009.05	No
Liu An	Supervisor	M	45	2006.05-2009.05	No
Han Guojun	Supervisor	M	51	2006.05-2009.05	No
Fu Zhongzhe	Vice President	M	46	2006.05-2009.05	No
Zhao Zhouli	Vice President	M	50	2006.05-2009.05	No
Dai Zhihao	Vice President	M	44	2006.05-2009.05	No
Cui Jian	Vice President	M	46	2006.05-2009.05	No
Zhu Junsheng	Vice President	M	46	2006.05-2009.05	No
Chen Ying	Financial Controller; Secretary to the Board of Directors	F	35	2006.05-2009.05	No
Chen Shouqun	Assistant of President	M	56	2006.10-2009.05	No
Li Yongxiang	Assistant of President	M	46	2006.05-2009.05	No
Xie Wei	Assistant of President	M	42	2006.05-2009.05	No
Lou Dingbo	Assistant of President	M	44	2006.05-2009.05	No
Jia Yanlin	Assistant of President	M	44	2006.05-2009.05	No
Wang Li	Assistant of President	M	50	2006.10-2009.05	No

Notes: (1) The term of office will end at the date when the 2009 Annual Shareholders' General Meeting is held.

(2) Ms Li Li, Chairwoman of the Board of Supervisors, bought 30,000 Baosteel shares during the report period. At the end of the period, Ms Li owned 30,000 shares of the Company. None of the rest of the directors, supervisors or senior managers owns any Baosteel shares.

## 2. Profile of Directors, Supervisors, and Senior Managers over the Last 5 Years

**Xu Lejiang**, Chairman of the Company since May, 2006; Director of the Company from February 2000 to May 2006; Director and Vice President of Shanghai Baosteel Group Corporation (hereinafter referred to as SBGC) from November 1998 to December 2004; Director and President of SBGC from December 2004 to October 2005; Director and President of Baosteel Group Corporation from October 2005 to December 2006.

**Ouyang Yingpeng**, Vice Chairman of the Company since February 2000; Director of SBGC from February 2003 to October 2005.

**Ai Baojun**, Director and President of the Company since May, 2006; Vice Chairman and President of the Company from February 2000 to May 2006; Chairman of Shanghai Baosteel & Arcelor Tailor Metal Co. concurrently.

**Li Haiping**, Director and Vice President of the Company since February 2000.

**He Wenbo**, Director of the Company since February 2000; Director and Vice President of SBGC from November 1998 to October 2005; Vice President of Baosteel Group Corporation since October 2005; Chairman of Baosteel Trading Co., Ltd. and Chairman of Bao-Island Enterprises Ltd. concurrently.

**Wu Yaowen**, Director of the Company since May 2006; External Director of Baosteel Group Corporation concurrently; Vice President of China National Petroleum Company since December 1996; Vice President of China National Petroleum Corporation since December 1998; and also Director and Vice Chairman of Petro China from October 1999 to December 2003.

**Laura Cha (Shi Meilun)**, Independent Director of the Company since May 2006; Non-official Member of the Executive Council of Hong Kong Special Administrative Region, Vice Chairwoman of Hong Kong & Shanghai Banking Corporation Limited, and Vice Chairwoman of the Panel of International Consultants for CSRC concurrently; Vice Chairwoman of CSRC from 2001 to September 2004.

**Buck Pei (Bei Kewei)**, Independent Director of the Company since May 2006; Associate Dean of the W. P. Carey School of Business, Arizona State University concurrently; Director of the MBA Program, Arizona State University, from June 1998 to May 2003.

**Katherine Tsang (Zeng Jingxuan)**, Independent Director of the Company since May 2006; President of Standard Chartered China concurrently; Inspector General of Structure & Study Department of Standard Chartered Bank from 2001 to 2005.

**Sun Haiming**, Independent Director of the Company since May 2006; Chairman of the Professor Committee, School of International Business Administration, Shanghai University of Finance and Economics (SUFU) and an Advisory Expert in Decision-making for Shanghai Municipal Government concurrently; Director of Research Center of Finance and Economics SUFE from 1994 to 2002; Chairman of School of International Business Administration SUFE from 2002 to 2006.

**Edward C. Tse (Xie Zuchi)**, Independent Director of the Company since May 2006; President of Booz Allen Hamilton Greater China concurrently; Executive Vice President of Hong Kong Telecommunication from February 2000 to October 2001; Vice President of AT Kearney from January 2002 to September 2002.

**Li Li**, Chairwoman of the Board of Supervisors of the Company since May 2006; Partner of Winthrop, Stimson, Putnam & Roberts (New York, Hong Kong) from 2000 to 2002; Partner and Chief Representative of Debevoise & Plimpton LLP since 2002.

**Zhou Zhuping**, Supervisor of the Company since May 2006; Director and Vice President of Shanghai Baosteel International Economic & Trading Co., Ltd. from November 2001 to February 2006; Director of Finance Department of Baosteel Group Corporation from February to July 2006; Business Supervisor and Director of Finance Department of Baosteel Group Corporation since July 2006.

**Zhong Yongqun**, Supervisor of the Company since May 2006; Vice Secretary of CPC Committee for Discipline Inspection and Director of Supervision Department SBGC from June 2003 to October 2005; Vice Secretary of CPC Committee for Discipline Inspection and Director of Supervision Department of Baosteel Group Corporation from October 2005 to May 2006; Vice President of Trading Branch of the Company from May to December 2006.

#### IV. Directors, Supervisors, Senior Managers and Employees

**Liu An**, Supervisor of the Company since May 2006; President of Ningbo Baoxin Stainless Steel Co. Ltd. from July 1998 to August 2004; Executive Vice President of Baosteel Group Shanghai No 1 Iron & Steel Co., Ltd. from August 2004 to March 2005; Executive Vice President of Baosteel Group Shanghai No 1 Iron & Steel Co., Ltd. from March to June 2005; Executive Vice President of the Stainless Steel Branch of the Company from June 2005 to May 2006; President of the Stainless Steel Branch of the Company since May 2006.

**Han Guojun**, Supervisor of the Company since May 2006; Director of the Corporate Cultural Department of the Company from September 2003 to May 2005; Secretary of the Commission for Discipline Inspection and Chairman of the Trade Union, Baosteel Branch of the Company since May 2005.

**Fu Zhongzhe**, Assistant to President of Shanghai Baosteel Group Corporation from June 1999 to June 2003; and also Chairman and President of Shanghai No.1 Iron & Steel Co., Ltd. since November 1999; Chairman and President of Shanghai No.1 Iron & Steel Co., Ltd. from June 2003 to March 2005; Vice President of the Company since April 2005, and President of Baosteel Branch since May 2005 concurrently.

**Zhao Zhouli**, Vice President of the Company since May 2000.

**Dai Zhihao**, Vice President of the Company from April 2002 to August 2003; President of Shanghai Baosteel International Economic & Trading Co., Ltd. from August 2003 to August 2005; President of Trading Branch of the Company from August 2005 to May 2006; Vice President of the Company since May 2006.

**Cui Jian**, Assistant to President of the Company and Executive Vice Director of Baosteel Research Institute from May 2001 to June 2003; Vice President of the Company as well as Director of Baosteel Research Institute and Director of the Technology Center from June 2003 to May 2006; Vice President of the Company since May, 2006.

**Zhu Junsheng**, Assistant to President of the Company from May 2001 to June 2003; Vice President of the Company since June 2003.

**Chen Ying**: Director of the Cost Management Department of the Company from May 2001 to November 2003; Secretary to the Board of Directors and Financial Controller since November 2003.

**Chen Shouqun**: Assistant to President of the Company from August 2002 to May 2005; Vice President of Baosteel Branch of the Company from May 2005 to October, 2006; Assistant to President of the Company since November 2006.

**Li Yongxiang**, Director and Vice President of Baosteel Group Shanghai Meishan Co., Ltd. of the Company from November 1998 to August 2004; Director and Vice President of Baosteel Group Shanghai Meishan Co., Ltd. as well as President of Shanghai Meishan Iron & Steel Co., Ltd. from August 2004 to February 2005; Chairman and President of Shanghai Meishan Iron & Steel Co., Ltd. from February 2005 to May 2006; Assistant to President of the Company as well as Chairman and President of Shanghai Meishan Iron & Steel Co., Ltd. since May 2006.

**Xie Wei**, President of Special Steel Branch of the Company from June 2005 to May 2006; Assistant to President of the Company as well as President of Special Steel Branch of the Company since May 2006.

**Lou Dingbo**, Assistant to President of the Company from September 2003 to March 2005; President of Sales Center of the Company from March 2005 to May 2006; Assistant to President as well as President of Sales Center of the Company since May 2006.

**Jia Yanlin**, Vice President of Shanghai Baosteel International Economic & Trading Co., Ltd. since September 2003; President of Raw Material Procurement Center of Baosteel Group Corporation from February 2004 to September 2005; President of Raw Material Procurement Center of the Company from September 2005 to May 2006; Assistant to President as well as President of Raw Material Procurement Center of the Company since May 2006.

**Wang Li**, Vice President and Senior Vice President of Shanghai Baosight Software Co., Ltd. since March 2002 to July 2005; Director and President of Shanghai Baosight Software Co., Ltd. since July 2005 to September 2006; Director of System Innovation Department of the Company from September 2006 to November 2006; Assistant to President as well as Director of System Innovation Department of the Company since November 2006.

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### 3. Annual Remuneration

Proposals for the annual remuneration of directors and supervisors are drafted by the Board of Directors' Remuneration and Appraisal Committee and submitted to the Annual Shareholders' General Meeting for approval. The compensation of senior managers is determined by the Board. The ranges of compensation are decided in accordance with and in consideration of the Company's business scale, operating conditions, and comparable levels in the job market.

The compensation of directors, supervisors and senior managers for the year 2006 totaled Rmb 17,910,000 (pre-tax), among which eight people ranged from Rmb 1,100,000 to 1,400,000 (pre-tax); five from Rmb 800,000 to 1,100,000 (pre-tax); one from Rmb 500,000 to 800,000 (pre-tax); and ten from Rmb 150,000 to 500,000 (pre-tax). The total of the three highest paid directors and senior managers was Rmb 3,990,000 (pre-tax).

The pre-tax annual allowance for outside directors and supervisors other than the independent directors is Rmb250,000 (Except Sun Haiming, who received the allowance for the whole year of 2006, all others were paid since May 2006). Expenses and fees for travel and accommodation incurred by outside directors and outside supervisors other than the independent directors, due to board meetings and shareholder's meetings are borne by the Company.

The Company discloses the ranges of the compensation of directors, supervisors and senior managers for the year 2006 to avoid unnecessary revelation of business secrets and stabilize the core team which is vital to the long-term growth and sustainable development of the Company.

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### 4. Appointment and Dismissal of Directors, Supervisors and Senior Managers

In accordance with the resolution of the 2005 Annual Shareholders' General Meeting, held on May 17, 2006, the second Board of Directors and Board of Supervisors served out their terms of office and, as a result, Ms. Xie Qihua, Mr. Zhu Yiming, Mr. Shan Weijian, Mr. Liu Huaijing, Mr. Gao Shangquan, and Ms. Hong Ying were no longer members of the Board of Directors of the Company and Mr. Zhao Ruyun, Mr. Chen Delin, Mr. Wang Chengran, Mr. Zhou Shichun, Mr. Zhang Jianzhong, Mr. Shan Xuyi, Mr. Sun Haiming, Mr. Sun Chiping, and Mr. Li Qiming were no longer members of the Board of Supervisors. Instead, Mr. Buck Pei, Mr. Ai Baojun, Ms. Laura Cha, Mr. Sun Haiming, Mr. He Wenbo, Mr. Li Haiping, Mr. Wu Yaowen, Mr. Xu Lejiang, Mr. Edward C. Tse, Ms. Katherine Tsang, and Mr. Ouyang Yingpeng started their terms of office as members of the third Board of Directors, among whom Mr. Buck Pei, Ms. Laura Cha, Mr. Sun Haiming, Mr. Edward C. Tse and Ms. Katherine Tsang act as Independent Directors. In addition, Ms. Li Li, Mr. Zhou Zhuping and Mr. Zhong Yongqun were members of the third Board of Supervisors.

Mr. Liu An and Mr. Han Guojun were elected as Employee Supervisors of the Board of Supervisors at the Staff Representatives' Meeting held on March 23, 2006.

At the first meeting of the new Board of Directors on May 17, 2006, Mr. Xu Lejiang was elected Chairman of the Board and Ouyang Yingpeng the Vice Chairman. The following appointments were made at the same time: Ai Baojun as President of the Company, Mr. Li Haiping, Mr. Fu Zhongzhe, Mr. Zhao Zhouli, Mr. Dai Zhihao, Mr. Cui Jian and Mr. Zhu Junsheng as Vice President of the Company, Ms. Chen Ying as the Financial Controller of the Company, Mr. Li Yongxiang, Mr. Xie Wei, Mr. Lou Dingbo, and Mr. Jia Yanlin as Assistant to President of the Company, and Chen Ying as Secretary to the Board of Directors.

Ms. Li Li was elected Chairwoman of the Board of Supervisors on May 17, 2006, at the first meeting of the third Board of Supervisors.

At the third meeting of the third Board of Directors on October 27, 2006, Mr. Chen Shouqun and Mr. Wang Li were appointed Assistant to President of the Company.

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### 5. Employees

As at the date of the Report, the total number of the employees of the Company and its subsidiaries were 38,720, including 23,546 who were involved in production, 11,496 in technical functions, and 3,678 in administration and management. Among them, 20,072 held three-year college degrees or higher ones. The total number of employees of the Company totaled 27,024, including 18,465 that were involved in production, 6,417 in technical functions, and 2,412 in administration and management. Among them, those held three-year college degrees or higher ones numbered 12,750. The company did not incur any expense for the retired employees in the year 2006.

## V. Corporate Governance

### 1. Progress in Corporate Governance

Ever since listed at the stock exchange, the Company has endeavored to create and execute, by means of standardizing its management and regulating its operation, a thorough and comprehensive corporate governance system in strict compliance with the *Company Law*, the *Securities Law*, as well as relevant rules and regulations issued by China Securities Regulatory Commission and the requirements set in the listing regulations by the Shanghai Stock Exchange. Efforts have also been made for further improvement.

As one of the first few companies in China which introduced the practice of independent directors, the Company has been well-known for its operational transparency in information disclosure, its interactive relationship with investors, and its strict and effective internal auditing and monitoring system, its risk-control systems, its credit in operation and transparency in management.

The third Board of Directors was elected at the 2005 Annual Shareholders' General Meeting on May 17, 2006. The new Board has 11 directors, including five independent directors, which take up 45 per cent of the total. In addition, Mr. Wu Yaowen has been trusted by the State-owned Assets Supervision and Administration Commission of the State Council as the outside director of Baosteel Group as well as director of the Company. The Board of Directors of the Company is more independent to run its own business and to improve its corporate governance.

At the same time, special committees under the leadership of the new Board were established, which include Strategic Committee, Auditing Committee, Remuneration and Appraisal Committee. The Chairmen and members of the committees were also elected. Mr. Xu Lejiang was elected Chairman of Strategic Committee, with one sixth of its members as independent director. Mr. Buck Pei, Independent Director, acts as Chairman of Auditing Committee, whose independent directors take up two thirds of its members. Ms. Laura Cha is Chairwoman of Remuneration and Appraisal Committee, whose members are all independent directors.

For better efficiency, the new Board elected four Executive Directors, who have been entitled to decide on certain affairs.

In the period reported, the *Corporate Charter*, the *Rules of Procedures for the General Meetings of Shareholders*, the *Rules of Procedures of the Board of Directors*, and the *Rules of Procedures of the Board of Supervisors* of the Company were amended in accordance with the new *Company Law* and *Securities Law*, as well as the *Guidelines for the Articles of Association of Listed Companies* (2006 amendments), *Rules of Procedures for the General Meetings of Shareholders of Listed Companies* and other relevant rules and regulations issued by China Securities Regulatory Commission and the requirements set in the listing regulations by Shanghai Stock Exchange. These documents were later approved by the 2005 Annual Shareholders' General Meeting. In addition, the rules of procedures for special committees of the Board of Directors were amended accordingly; these included rules of procedures for Strategic Committee, Auditing Committee, and Remuneration and Appraisal Committee, as well as new *Regulations for the President*.

The Company has decided upon the basic corporate governance framework and a schedule has been set for amendments of the essential management regulations for all the businesses, laying down the basis for a comprehensive system of management and operation. Efforts have also been made to improve the internal auditing system and the *Regulations for Internal Auditing*, approved by the Board of Directors, has been practiced.

According to the *Corporate Charter* of the Company, a top-down approval procedure must be followed in decision-making of great significance. Shareholders' General Meeting, Board of Directors, Executive Directors, and management have their own distinctive and respective rights, making an interactive and balanced system among management, decision-making, execution and supervision.

The current performance appraisal and remuneration systems for senior managers have been further improved. To encourage directors, supervisors, and other senior managers, the Board of Directors approved *Baosteel A-share Restricted Share Incentive Scheme*.

The performance of the Company in 2006 was well commented, as usual, by the capital market. For example, it was awarded the "Most Valuable Listed Company" in 2005 by the China Central Television and the "Most progress in investor relations" by *Investor Relations Magazine* (UK).

## 2. Performance of Independent Directors

In the report period, as the new Board of Directors was formed, a new generation of independent directors, who are well-known professionals in corporate strategy, enterprise management, finance, accounting and human resources, succeeded.

Encouraged by the excellent performance of the second Board, the new Board of Directors has been found to be a responsible team in that efforts have been made by the members soon after the Board was formed to better understand the profile, the strategic blueprint, and the performance of the Company. Discussions have conducted with the leadership and the administrative departments and constructive suggestions are made as regards to the strategic blueprint, internal auditing system, risk controlling, management of the subsidiaries, human resources, incentive scheme, communication, cross-regional operation and technological innovation.

It has been made a standard practice that the five independent directors and Wu Yaowen, sent by the State-owned Assets Supervision and Administration Commission of the State Council as the outside director, meet informally before a Board meeting is held. Such informal meeting has been held twice in 2006. In addition, Strategic Committee and Remuneration and Appraisal Committee held meetings to discuss the strategic blueprint and incentive scheme of the Company, respectively.

The independent directors are found to play an important role in the special committees. Led by independent directors, Auditing Committee and Remuneration and Appraisal Committee contribute professionally to the process of the Board of Directors' decision-making, greatly benefiting the corporate governance.

The independent directors attended, with a sense of responsibility and commitment, the Board meetings in the past year, making professional suggestions and advice to the Company in making decisions of significance and supervising the leadership in the interests of the Company and its shareholders. Altogether seven board meetings were held in the report period, two with the second Board of Directors and five with the new Board. The four directors on the second Board made eight attendances and the five on the new Board 23 attendances. The directors on the second Board attended two meetings of Auditing Committee and one of Remuneration and Appraisal Committee. The members on the new Board attended a meeting held by Strategic Committee, three by Auditing Committee and three by Remuneration and Appraisal Committee, commenting on issues of related party transaction, guarantees provided by the Company, and A-share incentive scheme.

Independent directors of the second Board	Number of board meetings convened in 2006	Attendance in person	Attendance by representative	Absence
Shan Weijian	2	2	-	-
Daniel Liew	2	2	-	-
Gao Shangquan	2	2	-	-
Hong Ying	2	2	-	-

Independent directors of the third Board	Number of board meetings convened in 2006	Attendance in person	Attendance by representative	Absence
Laura Cha	5	4	1	-
Buck Pei	5	5	-	-
Katherine Tsang	5	4	1	-
Sun Haiming	5	5	-	-
Edward C. Tse	5	5	-	-

## 3. Separation of Company's and Holding Company's Interests

Personnel: The Company is totally independent of and separate from Baosteel Group Corporation in regard to human resources and payroll management. The senior managers, including President, Vice Presidents, Financial Controller and Board Secretary, have not hold any concurrent positions in Baosteel Group.

Assets: The Company owns all of its production processes, including raw materials processing, sintering, coking, iron making, steel making and steel rolling, as well as related infrastructure and facilities, such as ships and ports. The Company also exercises complete authority over its research and technology, manufacturing, procurement and sales processes.

Organizational structure: The Company is totally independent of and separate from Baosteel Group Corporation with none of the Company's departments overlapping with those of or reporting to the holding company.

Sales and operations: The Company has full authority over its sales and operations management.

Finance: Equipped with its own finance and accounting department, the Company has independent accounting, auditing and financial management systems. All bank accounts of the Company are independent of the holding company and taxed separately.

## VI. Shareholders' Meetings

### 1. 2005 Shareholders' General Meeting

The 2005 Shareholders' General Meeting of the Company was held on May 17, 2006, in Beijing, and resolution was published in *Shanghai Securities News*, *China Securities News* and *Securities Time* on May 18, 2006.

## VII. Board of Directors' Report

### 1. Review of the Company's operation

The year of 2006 experienced a strong wave of mergers and acquisitions, with Mittal Steel's takeover of Arcelor as the biggest deal in the field. Under the guidance of Steel Industry Policy, the steel enterprises in China quickened the process of consolidation. As the national and international economies enjoyed a healthy growth and sound development, the domestic demand for steel products displayed a stable and rapid increase, while the growth in steel production began to be brought under control. As a result, the balance between supply and demand in the domestic steel market was, by and large, kept in the country, and the industry enjoyed a favorable performance. The prices of steel products increased steadily in both home and overseas markets, with the price deflation widened. Due to the rapid development of the industry as a whole, the demand for raw materials from steel industry kept rising and, consequently, the prices of iron ore, coal, and alloys increased dramatically. While the prices of iron ore fines and lumps had rose by 71.5 percent in the year of 2005, an increase of 19 percent was experienced in 2006. Alloy metals such as nickel, zinc and copper were also priced much higher. However, the Company has realized good operational result by taking full use of the opportunity and conducted its operation effectively. The annual sales of steel products totaled 21.405 million tons, and the sales income reached Rmb 157.79 billion, with a pre-tax profit of Rmb 19.01 billion, which marked a record high.

#### (i) Business scope and company strategies

With steel industry as its focus, The Company expanded its business into areas such as trade, shipping, coal chemistry, and information services. The key products of the Company include hot-rolled coils, cold-rolled sheets, hot-dip galvanized sheets, tin plates, color-coated sheets, silicon steel, seamless steel tubes, hot-rolled pickling plates, high-speed wire rod, stainless steel, and special steel, which are widely applied and used in industries such as automobile, home appliance, oil, machine manufacturing, energy and transportation, construction and decoration, metal products, aviation, nuclear power, and electronic panels.

The Company commits itself to be a world-class steel manufacturer and seeks to provide value-added products and services to the society. Taking trustworthiness, cooperation, innovation, and pursuit of the maximized corporate values as its core value, and "build itself into the most competitive steel enterprise in the world" as its strategic goal, Baosteel, on the basis of scale and technology, implements the leapfrogging development strategy featuring such major strategic measures as the development of circular economy, following the new trail of industrialization, adherence to management innovation, improvement of the Company's soft power, and increase of its core competence. The Company carries out the competitive strategy of "target focusing", concentrating on the development of such strategic products as auto sheets, silicon steel, pipeline steel, steel tubes for energy use, ship-building plates, stainless steel, and high alloy steel, in an effort to raise the comprehensive competitiveness of such products and maintain the Company's leading position on the domestic steel sheet market. It will adhere to the scientific concept of development and follow a road of industrialization featuring sustainable development.

### 2. Major tasks of the Company

#### (1) Promoting the integration of backbone steel business

In 2006, the Company proceeded steadily and orderly in promoting the integration of its backbone steel business. It implemented specialized management technology in all its production units for the 10 major areas such as production, equipment, energy, logistics, finance, etc, and established 7 production-sale-research teams for auto sheets, silicon steel, stainless steel and others. The further promotion of integration has obviously raised the Company's overall level of production technology, management efficiency, the speed of market response, customer's satisfaction, and the speed of new product development and has optimized its resources allocation and gradually reorganized and consolidated its advantages. The synergy tapped from the integration reached Rmb 2.48 billion in 2006.

#### (2) Compiling the Company's new round of development plan (2007-2012)

In view of the new situation in the development of domestic and international steel industries and the changes of the Company after the new share issuance and acquisition, the company has finished its new round of strategic planning, the scope of which has extended to cover not only the original carbon steel but such related areas as stainless steel, special steel and trading, chemicals and IT. In terms of intrinsic development, the Company focuses more on the construction of such soft powers as the ability of the overall system.

This round of planning is characterized by four major points: scale expansion, technology innovation, construction of the ability of the overall system, and recycling economy. By 2012, as the production capacity of the Company shall reach over 50 million tons and the sales income shall rise significantly, the Company shall build a steel production base with refined steel as its core, and boast a complete set of steel categories and specifications and product series, laying a solid foundation for building the Company into the most competitive steel enterprise in the world. The new round of development planning is an action guideline for the Company development in the next several years.

## VII. Board of Directors' Report

### (3) Production Organization

In 2006, the operation of all the production units of the Company continued to be optimised and the major technological and economic indexes registered obvious increases.

The subsidiaries of Baosteel proceeded smoothly and steadily in production and construction: among the 107 operating indexes in production and working procedure, 47 broke a record; they have successfully accomplished their production tasks and during this period the steel production and RH steel production increased dramatically compared with those of the previous year; they finished the overhaul of No. 2 blast furnace in 98 days in an effort to extend its capacity, which turned out to be the shortest time in super-large blast furnace overhaul in China.

The stainless steel branch, making full use of the opportunity of a better market, achieved new breakthroughs both in scale and profit. In 2006, the monthly production of both stainless steel and hot-rolled products exceeded 100 thousand tons; the major technological and economic indexes significantly improved and the non-planned blow off ratio of the blast furnace dropped by 1.4% compared with the previous year; the comprehensive energy consumption per ton of steel dropped by 39.6 kilograms of standard coal and the yield ratio of precious metals as nickel and chromium increased by 2.0% and 2.9% respectively.

The special steel branch, carrying on the difference management strategy for special metallurgy, stainless steel and structural steel, witnessed significant rise in its sales income and gross margin.

The Meisteel Co., striving to overcome such unfavorable factors as technology reform and annual revamping, tagged its full potentials and as a result its operation level had obviously improved and the proportion of the quality steel in 2006 increased by 5.2 percent compared with 2005; the comprehensive energy consumption per ton of steel dropped by 20 kilograms of standard coal as against 2005 and the rate of comprehensive utilization of resources rose by 1.9 percent as against 2005.

### (4) Marketing

Progress was made in marketing in 2006 with focus on market development of strategic products and new products.

Product structure continued to be optimized: 8.66 million tons of strategic products were sold; 2.65 million tons of auto sheets were sold in the fiscal year of 2006, a rise of 27% as against the previous year, among which 2.22 million tons were cold-rolled auto sheets, a yoy increase of 29%; 1.92 million tons of home appliance sheets were sold with a yoy increase of 17%.

By means of interference at the early stage, the Company had accelerated the pace of certification for auto sheet products, passed the certification of the steel and component parts of many key customers such as Honda, GM NA, and BMW Europe, improved and extended the channel for communication with major auto and ship-making customers. The sales volumes of the outer panel of refrigerators and home appliances with hot galvanized fingerproof and environmentally-friendly coating increased dramatically and a batch of well-known home appliance manufacturers became stable customers of the Company. A series of high value-added steel tubes were shipped in batches and the sales volume of the special thread series, corrosion resistance pipes, and alloy pipe series for boilers registered drastic increase. The sales volume of ERW products exceeded 100 thousand tons. A batch of new products, such as high-quality construction structural steel plates, bridge beam steel plates, high strength Q&T steel sheets, and three-layer color coated steel sheet, were used in such key projects as stadiums for the Olympics and the national oil reserve base in large amount, which greatly enhance the Company's product brand and social value.

The sales volume of stainless steel exceeded 1 million tons and its domestic market share was raised to over 20%. The market share of industrial plate of the stainless steel branch was further expanded and the speed of response to market continued to improve. The proportion of new and high-tech products of Ningbo Baoxin, such as series 400, continued to increase and the number of direct supply users increased strikingly.

The sales proportion of special steel strategic products increased dramatically to 52% and the sales volume of such high value-added species as high tempering alloy, die steel, and long stainless products saw dramatic rise. The product mix was further optimized.

The user-oriented marketing network continued to be improved and the capacity for value-added service further enhanced. In 2006, 9 new processing centers had established, enhancing the capability of cutting and processing and laser welding by a large margin. In 2006, the designed capacity for cutting and processing was 3.22 million tons.

Overseas marketing made breakthroughs. In 2006, the Company exported 2.98 million tons of steel, earning USD 2.0 billion of foreign exchange. The proportion of exports of high value-added products continued to increase, with the user coverage area continuing to expand.

### (5) Key projects being completed and put into operation

A batch of key projects were put into operation as scheduled such as the on-the-spot overhaul of the No.2 blast furnace of Baosteel branch, the No.4 continuous casting mill, the potential-digging and transformation project of No.2 steelmaking plant, the institution of the desulfurization equipment for the No.2 unit of the power plant, the production line transformation of high-alloy special

steel, and the rough milling transformation of Meisteel.

After such projects as the No.4 blast furnace, heavy plate Mill, ERW and the expansion project of stainless steel were put into operation, production had been increasing drastically and the Company could reach its designed capacity, standards and efficiency successfully and the projects had become a new growth point for the Company's profit. The sales volume of the heavy plate in 2006 was 1.11 million tons, an increase of 745 thousand tons as against the previous year, and the gross margin of the products was drastically increased. The sales volume of ERW in 2006 exceeded 100 thousand tons and the profitability rose on a monthly basis.

Along with a batch of key projects putting into operation, the full exploration of the production potential of projects for the 10th five-year period, and the high-quality production organization and operation, the Company's market shares for auto sheets, home appliance sheets, ship-building plates, petroleum pipelines, stainless steel and special steel further increased, greatly enhancing the Company's production efficiency and competitiveness.

#### (6) Independent innovation

For the first time, the Company issued the Development Guideline for Baosteel's Technology Innovation System, focusing on constructing a technology innovation system with "three in one" as its main content and striving to promote the translation of innovation into productivity. The annual investment in R&D was Rmb 1.39 billion. 656 patents had been applied, among which 312 were patents for inventions, and 1,890 technical know-hows were created. Technological innovation of the Company showed a trend of accelerated development.

The Company succeeded in developing a batch of high-grade new products like hot-rolling high strength construction steel with good welding ability, weatherproof steel and corrosion resistance steel, which met the demand of key industries and major projects. In addition, it also made progress in the development of high-grade series products of oil tubes, which generated fine economic results, succeeded in the trial production of X120 pipeline steel and the development of stainless steel for auto use, and made new breakthroughs in the research and development of stainless steel. Moreover, the Company succeeded in the trial production of duplex stainless steel and proceeded smoothly in the research and development of special metallurgy and special steel. It continued to produce quality auto sheets of Baosteel and had the ability to participate in the whole process of new car model design and development.

#### (7) Sustainable development

Aiming at building a world-class green steel manufacturing enterprise, the Company started from the development of recycling economy and fully promoted energy-saving and reduction, environmental protection and the comprehensive use of resources. As a result, major indexes of the above aspects had continued to improve and the environment was obviously getting better.

Following the three-year action plan of environmental protection of Shanghai, the Company fully promoted environmental management and construction and made visible progress in the establishment of a long-term management system. The Company had engaged in technology advances and a series of major environmental protection and treatment projects, such as the desulfurization and the dust-prevention and wind-shielding network of the No.2 unit of the power plant of Baosteel Branch, the waste water recycling equipment of Special Steel Branch, the waste water recycling projects at the west outlet of Meisteel, and the dust-removal transformation project of the iron-making plant, had been put into operation, which reduced the pressure of environmental protection. A batch of projects, such as the desulfurization of the sintering machine and the automatic system of environmental monitoring, supervision and management, had started to be implemented.

The Company adhered to the strategy of sustainable development and issued the 2005 *Report on Sustainable Development* on the basis of continued focus on and improvement of economic, environmental and social development. Following the Company's issuing of a report on environment, this one is another public message that reflects the enterprise's operational activities, exhibits the outlook of its employees and emphasizes the harmonious development of the enterprise, nature and society, showing the Company's strong responsibility in emphasizing environmental protection, focusing on recycling economy and accepting social supervision. The Company is the first enterprise in China's steel industry to publicize a report on sustainable development.

The Company makes efforts to work in line with the requirements of the government's environmental protection and management department, signing the *Target Responsibility Document on the Total Amount of Pollutants during the 11th Five-Year Period* and the *Target Responsibility Document on Energy-Saving during the 11th Five-Year Period* with the national and local governments. Focusing on the task of meeting the total amount of pollutants and energy saved during the 11th five-year period by 2010, a task allocated by the national and local governments, and the overall objective of building a world-class green steel manufacturer, the Company compiled a development plan for recycling economy, making a unified planning and arrangement for energy-saving, environmental protection, and the comprehensive use of resources in the next several years.

#### (8) Credit rating

On December 14, 2006, Standard & Poor's announced that the long-term credit rating of Baosteel was raised from BBB+ to A- and the Company's credit was stable seen from a long perspective, which showcases the Company's prudent operation and rapid development.

## VII. Board of Directors' Report

### (II) Analysis of the Company's operational results

1. In view of the consolidation and M & A of the international steel industry and the competition of domestic steel companies, the Company, through internal synergy, accelerated its project construction for the 11th five-year period, implemented the product differentiation strategy, and made efforts to reduce cost and increase efficiency, as a result of which the Company fully completed its objectives and tasks for production and management and its sales volume, income, and profit all reached a record high. In 2006, the sales of finished products reached 21.405 million tons, a 14.0% increase as against the previous year; the sales income amounted to Rmb 157.79 billion, a 24.6% rise as against the previous year; the pre-tax profit was Rmb 19.01 billion, a 3.8% increase as against the previous year; the net profit was Rmb 13.01 billion, a 2.7% rise as against the previous year.

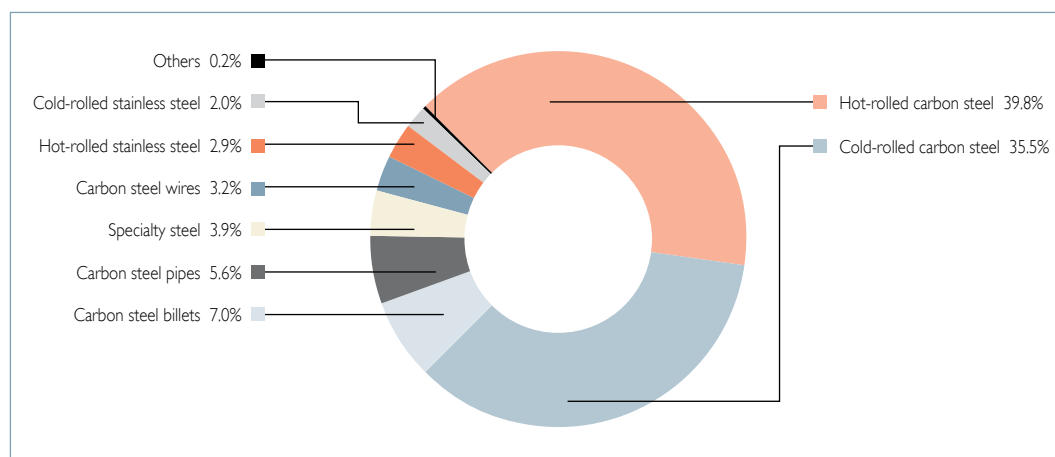
#### 2. Distribution of Income from Principal Businesses in 2006

(Rmb Million)						
Industry	Revenue	Cost of goods sold	Gross margin (%)	Change in revenue YoY (%)	Change in cost YoY (%)	Change in gross margin YoY
Steel	114,905	89,221	22.35	18.87	23.26	- 2.77
Trade	30,153	29,290	2.86	44.29	43.26	+0.7
Others	12,733	10,718	15.83	40.77	49.83	-5.09
Total	157,791	129,229	18.10	24.63	29.25	-2.93

Note: To highlight the cost of principle business of steel products, the scrappage has not been included in the category of "Steel", as was done before, and the figures of 2005 was adjusted for comparative purpose accordingly.

### 3. Major products

The following chart shows the distribution of sales volume of steel products in the period reported:



#### A. Carbon steel

##### Cold-rolled products

Shipments of cold-rolled products in 2006 reached 7,598,000 tons, accounting for 35.5% of total products sold. Cold-rolled products include standard cold-rolled coils, hot dip zinc galvanized plates, zinc electro-galvanized plates, color-coated plates, tin electro-galvanized plates, silicon steel, and full hard coils for use in automobiles, home appliances and packaging. With its national brand of auto sheet based on self-innovation, Baosteel has become a world first-class auto sheet provider, and the Company has enjoyed fame among its customers for its brand of auto sheet. The Company's home appliance sheets have been widely used in industries of the air conditioner, refrigerator, washer, micro-oven, color television, DVD player, computer, etc. Among them, the refrigerator outside plates, fingerprint resistant sheet and steel for television are high value-added products for high-end markets at home and abroad. As the leader in China's cold-rolled market, the Company sold 2.22 million tons of cold-rolled auto sheets and made up 51.7% of the mainland's market. The Company also dominates the domestic home appliance sheets market with a 36.8% market share, or 1.924 million tons. For higher-grade, non-oriented silicon steel, the Company accounted for 17.5% of the market, having sold a total of 859,000 tons in 2006.

##### Hot-rolled products

Shipments of hot-rolled coils totaled 8,520,000 tons in 2006, accounting for 39.8% of the Company's total sales volume. The hot-rolled steel products of the Company include pipeline steel and steel for railways and engines, steel for constructional purposes, steel for containers, and steel for ship-building plates (thick), which are used for pipelines, railway vehicles, construction, mechanical equipment and shipbuilding. The sales of broad and thick steel products, including pipeline plates, shipbuilding plates, structural plates, steel plates for boilers, weathering steel plates and steel mould plates, which are widely used in areas of shipbuilding, oil platforms, pipelines, boilers, pressure vessel and heavy-duty machines, reached 1.11 million tons, accounting for 5.2% of the total sales of steel products of the Company. The development and application of some high performance steel products, such as high strength ship plates, high performance pipeline steel, and oil container steel, filled gaps at the home market in 2006, with ship-building plate sales volume of 587,000 tons, accounting for 9.7% of the domestic market. Shipments of pipeline steel hit 445,000 tons in the period reported, accounting for 29.5% of China's domestic market.

##### Steel tubes

Total steel tubes sold in 2006 reached 1,189,000 tons, accounting for 5.6% of the Company's total sales volume. Steel tubes are mainly used for oil drilling wells, high-pressure boilers, and mechanical tubes, which are found to be used in petrochemical Industry, boiler building and mechanical processing, among which 13Cr tubulars, anti-corrosion steel and premium threads have reached a scale production and the high-end products such as T91 and T23 are found to be in short supply in boiler industry. In addition, T92 pilot production has been successfully launched. The low-carbon surface casing for ERW welded tubes has been widely used in oil industry and the line pipe has been applied in long-distance oil/gas pipelining in and outside China. The Company is a major supplier of steel tubes for oil wells in China, with an annual sales volume of 492,000 tons and a domestic market share of 17.9 per cent.

## VII. Board of Directors' Report

### Wires & rods

The shipments of wires and rods totaled 691,000 tons in 2006, making up 3.2% of the Company's total sales volume. The Company's major wire & rod products include steel cords, high performance spring steel, high strength steel strand, high performance cold forging steel, bridge cable, and microalloy welding wire, which are mainly consumed in auto industry, manufacturing of standard parts and bridge building. The Company's bridge cables are found to be used in Xihoumen Suspension Bridge and Sutong Stayed-cable Bridge, both being No.1 of its kind in the world. Sales volume of high performance forging steel reached 248,000 tons in 2006 with 13.3% domestic market share.

### Steel billets

The shipments of steel billets totaled 1,494,000 tons in 2006, making up 7.0% of the Company's total shipment of steel products. The Company's major products of steel billets include die steel, auto axle steel, oxygen bottle steel and other high value-added products. The Company is honored as the first producer of the B series of non-quenched and tempered steel. The sales of die steel of the Company in 2006 reached 194,000 tons, with a domestic market share of 13.3%.

## B. Stainless steels

### Hot-rolled stainless steel

The shipments of stainless steel totaled 619,000 tons in 2006, making up 2.9% of the Company's total shipment of steel products. While focusing on the austenitic stainless steel, the Company has also been involved in the production of ferritic stainless steel, martensitic stainless steel, 13Cr stainless steel, duplex stainless steel, ultra-low carbon stainless steel and ultra-low nitrogen stainless steel, which are mainly consumed by industries of cold rolling, manufacturing and products industry. The sales of the industry-oriented hot-rolled stainless steel products of the Company in 2006 totaled 245,000 tons, with a domestic market share of 40.9%, and the product-oriented products reached 252,000 tons, accounting for half of the home market share.

### Cold-rolled stainless steel

The shipments of cold-rolled stainless steel products, which are mainly for industries of home appliance, manufactured goods, decoration, elevators, and kitchen utensils, totaled 420,000 tons in 2006. The sales of the 304 series of cold-rolled stainless steel products totaled 320,000 tons, with a domestic market share of 13.4%; and sales volume of 430 series reached 65,000 tons, making up 10.7% of the home market share.

## C. Specialty steel

The shipments of specialty steels totaled 826,000 tons in 2006. The Company's major specialty steel product line-up includes the three series of special metallurgy steels, stainless steels and structural steels, which are widely used in aviation, space industry, environmental protection, electronics, powers, communications, oil industry, chemical industry, machinery, home appliance, auto industry, engines and medical equipment. The sales of the metallurgy steel products of the Company in 2006 totaled 45,000 tons, with a domestic market share of 14.2%, and that of the stainless series reached 140,000 tons, which accounts for 31.7% of the home market share.

The revenues and costs of major products of the Company are as follows:

(Unit: Rmb Million)

Products	Revenue	Cost of goods sold	Gross margin (%)	Change in revenue (% YoY)	Change in cost (% YoY)	Change in gross margin (YoY)
Hot-rolled carbon steel	31,488	22,663	28.03	15.17	33.39	Down 9.83 percentage points
Cold-rolled carbon steel	39,817	30,161	24.25	-0.41	2.94	Down 2.46 percentage points
Hot-rolled stainless steel	9,989	8,884	11.06	114.74	79.14	Up 17.67 percentage points
Cold-rolled stainless steel	8,873	7,673	13.53	119.01	63.4	Up 29.45 percentage points
Specialty steels	7,978	7,357	7.78	78.23	73.26	Up 2.64 percentage points
Other steel products	16,760	12,483	25.52	3.68	2.40	Up 0.93 percentage points
Total	114,905	89,221	22.35	18.87	23.26	Down 2.77 percentage points

#### 4. Major markets

The Company's revenue is mainly realized in domestic markets. The market share of the products at home shows a stable yearly growth as a result of the Company's endeavors on higher value-added product market and the efforts to cooperate with strategic customers at home and abroad. The direct sales and sales to strategic customers accounted for 75 per cent of the total in the year of 2006.

At the same time, efforts have been made by the Company to market 10 to 15 per cent of its products internationally, so as to raise its competitiveness in international markets. These include the cooperation with overseas strategic customers and direct customers to promote its strategic and new products and the trial practice of overseas representatives in various forms to better its overseas services. The domestic sales volume of the Company in 2006 accounted for 86.1 per cent of the total and those overseas made up 13.9 per cent, with revenues of Rmb 99.189 and 15.716 billion respectively.

#### 5. Major suppliers and customers

In 2006, the Company's total sales income from the top 5 customers accounted for 10.8% of the income from principle businesses.

In 2006, the Company's total procurement amount from the top 5 suppliers accounted for 26.1% of the annual procurement.

#### 6. Capital structure changes

As at the end of the reported period, the total of the consolidated assets of the Company reached Rmb 151.06 billion, with an increase of 9.04 billion as compared with that at the beginning of the year. The total liabilities were Rmb 64.19 billion, Rmb 1.09 billion more than that at the beginning of the year. The shareholder's equity reached Rmb 81.96 billion, with an increase of 7.49 billion as compared with that at the beginning of the year. The liability/asset ratio of the Company was 42.5%, a drop of 1.9% as compared with that at the beginning of the year.

Unit: Rmb million

Assets	As at the end of 2006	As at the end of 2005	Increase/Decrease	Liabilities and shareholders' equity	As at the end of 2006	As at the end of 2005	Increase/Decrease
Current assets	51,611	47,098	4,513	Current liabilities	47,266	42,678	4,588
Include: Inventory	31,515	25,046	6,468	Include: short-term loans	19,973	10,777	9,196
Receivables	10,383	13,259	-2,877	Long-term liabilities	16,771	20,213	-3,442
Long-term investment	2,713	2,871	-159	Include: long-term loans	15,095	16,195	-1,100
Fixed assets	94,334	89,227	5,107	Total liabilities	64,185	63,097	1,087
Intangible Assets and Other Assets	1,674	2,167	-493	Shareholders' equity	81,961	74,475	7,485
Total Assets	151,060	142,024	9,035	Total liabilities and shareholders' equity	151,060	142,024	9,035

The increase of Rmb 6.47 billion in inventory at the end of the reported period as compared with that at the beginning of the period was mainly due to rise in the cost of raw materials such as nickel and stainless scraps, which increased the inventories of stainless steel series and special steel series. The total fixed assets of the Company grew by 5.11 billion, including Rmb 18.2 billion of new investments and Rmb 12.3 billion of depreciation on fixed assets.

As at the end of the period reported, the balance of the interest-bearing liabilities (excluding notes payable to controlling company) totaled Rmb 35.43 billion, an increase of 6.04 billion over that at the beginning of the period reported.

## VII. Board of Directors' Report

### 7. Expenses and income tax changes during the reported period

#### A. Operation and management expenses

Unit: Rmb million

Item	2006	2005	Difference	Difference rate
Operation expenses	2,239	1,607	632	39%
Management expenses	5,388	5,095	293	6%

The operation expenses and management expenses show an increase over those of the previous year, mainly because those of 2005 covered only the expenses from May to December.

#### B. Financial expenses

Unit: Rmb million

Item	2006	2005	Difference	Difference rate
Interest income	-91	-64	-27	41.91%
Interest paid	1,724	1,263	461	36.56%
Exchange gains or losses	-383	-192	-191	99.26%
Others	56	37	19	50.94%
Total	1,306	1,044	262	25.25%

Note: "-" means increase in gains.

The Company's financial expenses in 2006 increased by 25 per cent as compared to that of 2005, mainly due to increase in interests paid. The four more months represented an increase of interest expenditure of Rmb 370 million, which was also partly due to the two increases in interest rate quoted by the People's Bank of China as well as the expanded fund-raising scope. Furthermore, thanks to the influence of over 3% RMB appreciation and the Company's timely financing in US dollar, the Company gained more than Rmb190 million in exchanges.

#### C. Income tax

Unit: Rmb million

Item	2006	2005	Difference	Difference rate
Consolidated pre-tax profit	19,008	18,311	697	3.81%
Consolidated income tax	5,545	5,777	-231	-4.00%
Income tax rate	29.2%	31.6%	Down 2.4 percentage points	

The pre-tax profit in the consolidated financial statements reached Rmb19.01 billion in 2006, an increase of Rmb 0.7 billion or 3.8% over the previous year. The income tax expenses reached Rmb5.55 billion, a drop of Rmb0.23 billion or 4% against that of the previous year, which was mainly due to the income tax of some of its subsidiaries which made a profit in 2006 is paid after made up its losses resulted from the previous year.

### 8. Cash flow analysis

In 2006, net cash inflows from operating activities reached Rmb 21.6 billion, and net cash outflows from investing activities hit Rmb17.22 billion and net cash inflows from financing activities totaled Rmb3.93 billion.

Compared to 2005, the net cash flows from operating activities decreased by Rmb1.13 billion in 2006, including a growth by 2.03 billion in net profit and depreciation. The Company enjoyed a better year in reflow of corporate sales income to the banking system, with a lower proportion of settlement by bill and consequently a drop of receivables by Rmb2.88 billion. The increase of Rmb 6.47 billion in inventory at the end of the reported period as compared with that at the beginning of the period was mainly due to rise in the cost of raw materials of stainless steel such as nickel.

The net cash outflows from investing activities increased by Rmb17.49 billion in 2006, including the Rmb25.34 billion used to acquire the target assets and equity of Baosteel Group. As 2006 experienced a record high in project construction due to the Eleventh Five-Year Plan of the Company, the purchase of fixed assets, incorporeal assets and other long-term assets incurred a total of Rmb8.07 billion more in 2006, as compared with that in the previous year.

The net cash flows from financing activities decreased by Rmb17.71 billion in 2006, as compared with that in the previous year, due to the Rmb25.41 billion of net cash from new issuance in 2005 and the Rmb6.36 billion of new liabilities in 2006.

## 9. Major subsidiaries and joint entities

- **Shanghai Meishan Iron & Steel Co., Ltd.**

As at the end of 2006, the Company had 74.0% shareholding of Shanghai Meishan Iron & Steel Co., Ltd. With a registered capital of Rmb6.26 billion, Meishan Steel specializes in smelting, pressing and sales of ferrous metals. By the end of 2006, Meishan had a total asset size of Rmb12.07 billion and a net yearly profit of Rmb0.92 billion.

- **Ningbo Baoxin Stainless Steel Co., Ltd.**

As at the end of 2006, the Company had 54% shareholding of Ningbo Baoxin Stainless Steel Co., Ltd. With a registered capital of Rmb2.85 billion, Ningbo Baoxin's business mainly covers the manufacturing and processing of stainless steel sheets and relevant technical guidance and consultation. By the end of 2006, Ningbo Baoxin had a total asset size of Rmb8.33 billion and reported a net profit of Rmb0.11 billion in 2006.

- **BNA Automotive Steel Sheets Co., Ltd.**

The Company owns 50% of BNA Automotive Steel Sheets Co., Ltd. as at the end of 2006. The subsidiary has a registered capital of Rmb3 billion and is mainly engaged in the production and sales of cold-rolled coils, hot dip galvanized plates and electro-galvanized plates used on autos and auto parts. Baosteel-NSC's assets totaled Rmb3.011 billion and reported a net profit of Rmb180 million in 2006.

- **Yantai Lubao Steel Tubes Co., Ltd.**

As at the end of 2006, the Company owned 79.8% of Yantai Lubao Steel Tubes Co., Ltd. (Lubao Steel Tubes). With a registered capital of Rmb100 million, Lubao Steel Tubes is mainly engaged in the processing and sales of seamless steel tubes. Its major products include structural seamless steel tubes, low/medium/high pressure boiler seamless tubes, seamless pipelines for transportation of fluids, hydraulic seamless tubes, as well as seamless tubes for oil pipelines, geological drillings, oil pipelines and oxygen canisters. Lubao Steel Tubes had total assets of Rmb890 million and net profits of Rmb150 million as at the end of 2006.

- **Baosteel Huangshi Coating and Galvanizing Co., Ltd.**

As at the end of 2006, the Company had 39.4% shareholding of Baosteel Huangshi Coating and Galvanizing. With a registered capital of USD8,000,000, Huangshi specializes in the production and sales of cold-rolled coils, aluminum galvanized steel plates, color-coated steel plates and related galvanized steel products. Huangshi had a total asset size of Rmb230 million and a net profit of Rmb13 million in 2006.

- **Shanghai Baosteel International Economic & Trading Co., Ltd.**

As at the end of 2006, the Company had a full shareholding of Shanghai Baosteel International Economic & Trading Co., Ltd. With a registered capital of Rmb2.25 billion, Shanghai Baosteel International Economic & Trading is mainly engaged in the imports and exports of goods and technology approved by the government, the imports of steel products and scraps, processing with imported materials and compensation trade. Shanghai Baosteel International Economic & Trading had a total asset size of Rmb29.32 billion and a net profit of Rmb1.24 billion in 2006.

- **Shanghai Baosight Software Co., Ltd.**

As at the end of 2006, the Company had 55.5% of shareholding of Shanghai Baosight Software Co., Ltd. ("Shanghai Baosight"). With a registered capital of Rmb260 million, Shanghai Baosight is mainly engaged in computer, automation, network communication and the research, design, development, manufacturing and integration of softwares and hardwares. Shanghai Baosight had a total asset size of Rmb1.05 billion and a net profit of Rmb80 million in 2006.

- **Overseas subsidiaries**

By the end of 2006, the Company has eight overseas subsidiary companies in the U.S.A., Japan, Germany, Singapore, Brazil, Hong Kong and other countries and regions. These overseas subsidiaries extend the Company's sales and purchase network, and play a critical role in enhancing the Company's international competitiveness.

## VII. Board of Directors' Report

### 3. Outlook of the Company's future development.

#### 1. Trend in steel industry and the market competition situation

##### (1) Development trend in steel industry

In 2006, the world output of crude steel totaled 1.24 billion tons, up 8.8% year-on-year. China's output of crude steel reached 420 million tons, an increase of 18% over that of the previous year, which dominates over 33.8% of the international market.

The steel industry in China is enjoying a stable growth and China, along with other new developing economies, is becoming a major driving force behind the growth in steel production and consumption in the world. Meanwhile, the international steel production and consumption is experiencing a shift from mature market of the developed countries to developing countries, especially the emerging developing economies such as China, India, Latin America, Africa and the Middle East. It can be optimistically expected that the global steel industry is enjoying a brand-new era.

Competition against the background of globalization in the world steel industry is characterized by the following unique features:

First, cross-country and cross-region integration, annexation, and reorganization tend to become continuously consolidated and concentrated. In the future years, apart from Arcelor Mittal, a number of steel enterprises with a production of about 100 million tons will emerge in the world steel industry due to expansion, competition and cooperation. The original lay-up of the world steel industry featuring "many enterprises competing for superiority" will gradually change and a new one featuring "many competing enterprises under a super strong enterprise" will be gradually formed.

Second, with the continuous technological progress, the mix of iron and steel products becomes increasingly advanced and competition in the area of high-end products is tuning much fiercer. Control of the key production technology and major technical process in the field of high-end steel sheets has become an important means to maintain competitive edges.

Third, control of strategic resources and competition for strategic users turn out to be an important means for steel enterprises to obtain competitive advantages. Therefore, the construction and improvement of the strategic supply chain become another new focus of competition.

Fourth, with the deteriorating of the global environment and the increasing pressure on environmental protection, steel enterprises have unanimously chosen to follow a road of sustainable development. Circular economy will become an important base for the technology roadmap of steel industry and will emerge as a new market barrier for the further development of and the entry into the specified international market.

The basic trend of the development of China's iron and steel industry:

The future period of time will be an important period of strategic opportunities for the development of China's steel industry. It will also be a key phase of development for China to turn from a major steel producer to a strong one.

Ever since 2005 when China implemented the steel industry policy, China has accelerated its adjustment of the industrial structure of the steel industry, making due progress in such aspects as knocking out backward capacities and controlling investment in the steel industry, in particular, investment in low-end product projects. As a result, the independent innovation ability of enterprises has been enhanced. In order to strengthen the overall competitiveness of domestic steel enterprises, the consolidation of these enterprises has been substantially launched. It can be predicted that in 2007, with the further implementation of China's industrial policies in the steel industry, the continuous exertion of the effect of these policies, and the sustained increase of the independent innovation ability of steel enterprises, the problems plaguing the development of China's steel industry, such as overcapacity, surplus of low-end products, and slow increase in concentration, will be better handled and the overall strength and international competitiveness of China's steel industry will be further improved.

In the future, China's steel industry will gradually move towards a new phase of intensive growth characterized by the leadership of big enterprise groups, concentration on structural adjustment and regional lay-out, emphasis on the ability of independent innovation, and great efforts in the development of circular economy and taking steady but rapid development as its main theme.

(2) The pattern of market competition

With the acceleration of consolidations and the continuous stepping-up of the effort to raise industrial competitiveness and extend industrial structure adjustment, the competition pattern on China's steel market is certain to undergo profound changes. At present, consolidation of the domestic steel industry starts to accelerate and the scale of production of steel enterprises is in rapid expansion. In 2006, 9 domestic enterprises exceeded 10 million tons in crude steel production and two exceeded 20 million tons. According to the industrial policy, it is required that a super-large enterprise group with strong competitiveness on the international market should be formed by 2010 which will have 2 enterprises with a capacity of producing 30 million tons of crude steel and a number of enterprises with a capacity of 10 million tons.

Baosteel has continued to maintain its competitive edge in the high-end product area it specializes in despite the current fierce competition both at the international and domestic markets. In 2006, the structure of product types of Baosteel has been further optimized and sales volumes of strategic products and Only One/Number One products has drastically increased.

In the field of carbon steel products, the market shares of the Company's strategic products—cold-rolled auto sheet, home appliance sheet, tin plate, and pipeline steel—are respectively 51.7%, 36.8%, 21.3%, and 28.8% on the domestic market, continuing to rank high in China. While continuing to maintain and expand the leading advantage, the Company shall meanwhile make great effort to develop such products as cold-rolled silicon steel and heavy plate for ship-making.

In the field of stainless steel products, the Company's amount of hot-rolled products continues to maintain a leading position in China and the sales volume of its stainless steel products has exceeded 1 million tons, with a domestic market share of over 20%. In the near future, with changing supply and demand situation on the domestic market, competition on stainless steel market will be more intense. The Company's cold-rolled stainless steel production will continue to maintain the second position in China.

In the field of specialty steel products, the sales proportion of strategic products rose drastically to 52% and the sales volumes of such high value-added species as super alloy die steel, and stainless steel long sections increased by a large margin. As the production line of stainless steel long sections reaches the designed capacity and the production line of high alloy bars is put into production, the structure of special steel products will be further optimized and specialty steel products will move towards specialization and scale production. The production capacity of key specialty steel species will also be further improved.

## VII. Board of Directors' Report

### 2. Future development strategy of the Company

#### (1) Opportunities for the Company's future development

Guided by the scientific concept of development, during the 11th five-year period, China is expected to maintain steady and rapid economic growth. Though the GDP in 2007 might slow down a bit, it will continue to maintain a relatively high level of growth. The structure of the national economy will continue to adjust and the domestic consumption of steel is estimated to drop slightly. However, the speed of eliminating backward capacities is stepping up and the growth in production capacity is increasing less rapidly. The steel market will maintain a basically stable pattern of demand and supply. Some leading industries for national economic development which are the major areas in which steel is used, such as construction, machinery, automobile, shipbuilding, home appliances, petroleum and natural gas, will continue to maintain steady growth. Therefore, the overall domestic demand for steel will steadily grow.

Currently, China is at the stage of rapid industrial development. With the continuous promotion of the country's industrialization process and the constant increase of its urbanization, China will undergo greater changes in economic, industrial and demand structures. China's domestic economy will become more internationalized and the country's role as the base of the world manufacturing industry will gradually establish. A new surge of consumption with housing and automobiles as the core and home decoration, deluxe luxuries, electronic and telecommunications products and tourism as a supplement will ensure the steady and rapid growth of demand for high-grade steel sheets.

In recent years, China has started to optimize the structure of its steel products. Despite the fact that the export of low-end products has been relatively reduced and the import of high-end products has relatively declined, there still exists a gap for the substitutes of high-end steel products. Meanwhile, with the rise of the technical level of the domestic steel industry and the increase of demand on the foreign markets, there is a steady growth in the demand for China's middle and high-end steel products. In 2006, China imported 18.51 million tons of steel, which is 7.3 million tons less than the 25.81 million tons in 2005. However, steel sheets and pipes still accounted for 88% of the total, among which the sheet plate, coated products, and electrical steel sheets made up over 63%.

The steel industry policy guides China's steel industry into a new phase featuring the strategic reorganization spearheaded by big enterprise groups. The state's relevant policy and measures provide support to domestic regional market layout and adjustment, offering strategic opportunities for the Company to achieve leapfrogging development. In 2006, Baosteel basically completed the preparation for reorganization with Ba Yi Steel, creating favorable conditions for the Company to implement its new round of development planning and realize leapfrogging development.

In 2007, the global economy and steel market will continue to maintain stable development and domestic economy will also maintain rapid growth, which will provide a fine space of growth and opportunities of development for China's steel industry. The country will continue to encourage steel enterprises to intensify their efforts in consolidation, offering a relatively large space of development for the Company to continue to conduct optimized allocation of resources, better meet the product demands of downstream industries, strive to develop and realize substitutes for imports, and expand the implementation of the strategy of producing high-end products.

#### (2) Challenges for the Company's future development

The Company shall be confronted with competition both from domestic steel enterprises that continue to expand their production capacity at low cost and strive to win through advanced technology and equipment and from world-class steel enterprises overseas in the field of high-end products and their capital expansion in China.

Steel price on the global steel market was a record high in 2006 and in 2007 it will continue to maintain relatively stable growth with slight fluctuations. The domestic steel price is expected to remain lower than that on the international market and the price of raw materials for steel, including that of iron ore, remains at a high level. The above factors work together to form double pressure on the Company's profitability and cash flow.

Judging from the environment for sustainable development, the expansion of the Company's scale is restricted by resources and environment. At the period when ore price is high, the Company has to make more effort to maintain its competitive advantage in competition in resource cost with other steel enterprises that enjoy superior iron ore resources. With the country's constantly increasing requirements for steel enterprises in energy conservation and environmental protection, the Company is confronted with greater pressure on energy conservation and environmental protection.

The globe-wide fluctuation of foreign exchanges, the rapid appreciation of the RMB, and the fluctuation of the price of strategic resources will lead to market uncertainty, which in turn will pose a new challenge to the Company in its ability to adapt to changes and guard against and control risks and in its foreign trading activities.

#### (3) Future development strategy for the Company

As a rapidly growing world-class steel enterprise, the Company, based on its previous development, commits itself to be a world-class steel manufacturer and seeking to provide high value-added products and service to society. Taking trustworthiness, cooperation, innovation, and pursuit of the maximized corporate value as its core value, and "building itself into the most competitive steel enterprise in the world" as its strategic goal, it, on the basis of scale and technology, implements the leapfrogging development strategy featuring such major strategic measures as the development of circular economy, following the new trail of industrialization, adherence to management innovation, improvement of the Company's soft power, and increase of its core competitiveness. The Company carries out the competitive "focusing strategy", concentrating on the development of such strategic products as auto sheets, silicon steel, pipeline steel, steel pipes for energy use, ship plates, stainless steel, and high alloy steel, in an effort to raise the comprehensive competitiveness of such products and maintain the Company's leading position on the domestic steel sheet market. It will adhere to the scientific concept of development and follow a road of industrialization typical of Baosteel that features sustainable development.

### 3. Plan for capital demand and use

In accordance with the implementation plan for fixed assets investment program in 2007, the Company is estimated to invest a total of Rmb 22.7 billion. The investment comes from the Company's own capital and debt financing.

### 4. Risks and measures

#### (1) Major risks

In 2007, the world economy might slow down on the premise of overall good estimation. America's adjustment of its housing industry will possibly cause a slow-down in its economic development and the world's other economies may possibly decline in their speed of development. All these factors will have an impact on the demand of the domestic and international steel markets and will bring about more uncertainties to sales of the Company's steel products.

In 2007, the possibility for China to raise its bank interest rate and legal reserve rate is quite high, which will bring about new uncertainties to the development of steel enterprises and their related upper and lower stream industries and to the Company's cash flow and capital operation.

The market price of the global steel market has become stable since the latter part of 2006, but there still exists uncertainty in 2007. Policy factors and non-policy factors such as the appreciation of Rmb, the tightening-up of export tariff rebates, and the intensified frictions in international trading, will curb growth in steel export. The domestic steel market will continue to be confronted with the pressure of capacity addition and the imbalance between demand and supply is possible to increase.

While deepening its macro-control, China intensified its efforts for macro-control in 2006. It made a comprehensive use of policies and measures in such aspects as taxation, bank interest rate, the real estate industry, environmental protection, and land, bringing about huge impact on the development of the domestic steel industry and the production and management of steel enterprises. The effect of these policies will be more clearly seen in 2007.

The price of fuels and raw materials such as iron ore will continue to remain at a high level, which will constitute a severe challenge to the Company's profitability.

#### (2) Measures of risk prevention

The Company will make great effort to optimize the mix of products and of steel products for export, give full play to its own comprehensive advantages, and seizing the opportunity of China's development of steel industry, continue to focus on the development of new products, regarding the new 11th five-year plan both as a starting point and as an opportunity. Giving priority to the development of fine products at low cost with foresight and taking into consideration environmental protection, the Company will spare no efforts to cultivate and raise the independent innovation ability and continue to carry forward the spirit of "developing products either unique of Baosteel or with better performance" in the field of high-end products. Meanwhile, seizing the opportunity that China has not completed the substitutes for high grade steel products, it will realize and expand Baosteel's domestic market share for the substitutes of high grade steel products.

The company will further strengthen the construction of strategic supply chain and the ability to secure strategic resources, continue to maintain and expand cooperation with domestic and international related enterprises and strategic suppliers, and meanwhile, make effort to research on the use of raw materials low in quality and cheap in price by means of coordination among units of production, supply and research.

The company, on the basis of the popularization of modern management technologies and propped up by informationization, will continue to improve its overall operational efficiency and results taking the integrated operation of major steel business as the main line, the pilot experiment of coordinated management of multiple units engaging in producing the same species of products as an opportunity, and the process combing and optimization as a starting point.

The Company will strengthen the coordination between steel business and the related industries, continue to reduce cost and increase efficiency on a full scale, and make effort to tap its own potentials, so as to raise its full competitiveness. It will deepen the system innovation typical of Baosteel, make greater endeavor to protect the environment and conserve energy, and transform Baosteel into an energy-saving enterprise that follows a sustainable circular economy.

The Company will continue to adjust and improve the foreign currency transaction structure, realize the natural hedging of foreign exchange risks. It will abide by the stable and controllable risk management principle and constantly optimize its foreign exchange assets and debt structures to avoid risks resulting from fluctuation of foreign exchange rate and bank interest rate by means of active and flexible use of such derivative financial instruments as forward exchange transaction, currency swap, and interest rate swap.

The Company shall further improve its interior risk control system; strengthen construction of the system of risk management in such aspects as the supply chain and technological innovation.

## VII. Board of Directors' Report

### 5. Impact of the new *Accounting Standards* on the financial and business performance of the Company

The Company will adopt the new, revised *Accounting Standard for Business Enterprises* (2006) in the year of 2007. The following is an analysis of possible changes in accounting policy and accounting estimates of the Company due to the new Standards and their impact on its financial and business performance:

(i) According to the *Accounting Standard for Business Enterprises No. 2 - Long-term Equity Investment*, the cost method will be adopted to re-value the investments of its subsidiaries. It is believed that this will result in a decrease in the carrying amount of investment income in a few statements. As the *Minutes of Coordinating Group Meeting Regarding Application of the New Accounting Standard for Business Enterprises* (Issue 2, 2007) indicates, dividends from the year before the adaptation of the new Standard from subsidiaries should be listed in an accounting book for checkup; and the accumulated undistributed profits from the previous year to the day of application of the new Standard should be booked as refund of investment cost, which needs to be included in the long-term equity investment cost in individual statement. As a result, the change will bear greatly in terms of finance on individual statements of the Company, as, when the dividends of the previous year are distributed in 2007, the profits are not able to present in the individual statements. However, the change will not make significant difference in the consolidated statement;

(ii) *Accounting Standard for Business Enterprises No. 6 - Intangible Assets* will be applied to re-categorize some of the rights of land use, from fixed assets to Intangible Assets, which will not be found to bear on the financial and business performances of the Company;

(iii) As stipulated in *Accounting Standard for Business Enterprises No. 16 - Government Grants*, incomes from government grants will be booked in categories of non-operating income or deferred income; the change will not be found to bear significantly on the performance of the Company;

(iv) The Company will also re-identify the liabilities of deferred income taxes according to the conditions set in the *Accounting Standard for Business Enterprises No. 18 - Income Taxes*. The change will not be found to bear significantly on the performance of the Company;

(v) The *Accounting Standard for Business Enterprises No. 20 - Business Combinations* will be adopted to differentiate business combinations under common control and business combinations not under common control, and accounting recognition will be made. As business combinations are individual cases as for companies, the change will not be found to bear significantly on the gains and losses of the Company;

(vi) The short-term investments and foreign exchange transactions will be re-categorized according to the new *Accounting Standard for Business Enterprises No. 22 - Recognition and Measurement of Financial Instruments*, and accounting recognition will be made. The change will be found to bear on the business performance of Baosteel Group Finance Co., Ltd., the Company's finance subsidiary.

(vii) In accordance with the new *Accounting Standard for Business Enterprises No. 33 - Consolidated Financial Statements*, all the subsidiaries of the Company will be consolidated financially and at the same time jointly controlled companies, which were included using the proportional consolidation method, will be excluded from the consolidated financial statements. As a result, Baosteel Finance will be included, while Bao-Island Enterprises and Baosteel-NSC/Arcelor Automotive Steel Auto Sheets will no longer be consolidated. The change will be expected to bear on the structure of the balance sheet of the Company;

(viii) The *Accounting Standard for Business Enterprises No. 38 - First time Adoption of Accounting Standards for Business Enterprises* will be applied to adjust historically the categories of long-term investment, financial instruments and income tax.

As required by the *Accounting Standard for Business Enterprises*, a model historical adjustment was done according to *Accounting Standard for Business Enterprises No. 38 - First time Adoption of Accounting Standards for Business Enterprises*. The results show that, as on the December 31, 2006, the shareholders' equity is Rmb 81.285 billion as valued by the new standard, against the original 81.961 billion

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#### 4. 2007 Business Plan

The overall operational objective of the Company for the year of 2007 is: Strengthening the integration, promoting the soft power, enhancing the competitiveness, and working for new markets and sustainable development. Specifically, the management target is expected to be a total income of Rmb159 billion, a total integrated synergy of 1.5 billion, and R & D expenditure/sales revenue rate of 1%, and energy consumption per ton less than 725kg. The Company has set a production target of 20.75 million tons of iron and 23.27 million tons of steel, sales volume of 22.19 million tons of steel products, with a total revenue of Rmb159 billion and cost of goods sold of Rmb132 billion from its principle businesses.

## VII. Board of Directors' Report

### 5. Investment Overview

Deployment of internally generated funds

In 2006, 4 key projects including the No.4 Continuous-casting and Refined Casting Equipment Project and the No. 2 Blast Furnace On-site Overhauling Project have been completed and put into operation with No. 3 Hot Rolling Mill Strip Project and Majishan Port Expansion Project still under construction. In addition, planned key projects such as the Project of No. 5 Cold-rolled Strip Steel and UOE Project at Baoshan Branch and Stainless Cold-rolling Mill Project at Stainless Branch have been initiated. Details are as follows:

#### 1. Projects completed

##### (1) No. 4 Continuous-casting and Refined Casting Equipment Project

The Company successfully completed a heat duration test run of the No.6 converter on 7th December 2006, 44 days ahead of the schedule, which was an indication that the Potential Tapping of No.2 Steel Making Plant has been fully completed. The successful completion of the heat duration test of the No.4 continuous caster on 16th December was also found to be 56 days ahead of the schedule. When completed, the capacity of the project will reach 2.7 million tons.

##### (2) No. 2 Blast Furnace On-site Overhauling Project

The furnace began to be overhauled on the 1st September 2006 and, a period of 98 days brought it back into service, which made a history in overhauling ultra-large furnaces. The new furnace has shown great improvement and its technological facilities and controlling devices have reached advanced level in the world.

##### (3) Upgrading Project of Production Line of High Alloy Steel in Specialty Steel Branch

The production line of the high alloy steel was brought into service after trial operation on 15th December 2006. The annual output is expected to reach 100,000 tons.

##### (4) Upgrading of the Main Driving Systems of 1422 Blooming and Finishing Rolling Mill at Meisteel

As the main driving systems and the blooming facilities were completed on 30th June 2006, thin hot-rolled coils have come to dominate, with qualities and varieties considerably improved.

## 2. Projects-in-progress

### (1) No. 3 Hot Rolling Mill Strip Project

This is a unit of 1880mm continuous annealing cold-rolled coil production line. The project began on 23rd May 2005 and the line will see completion in the first half of 2007. When brought into operation, an increase of 3.7 million tons of hot-rolling capacity is expected.

### (2) Majishan Port Expansion Project

The designed annual processing capacity is 30 million tons, including half in-taking capacity and half delivery capacity. The project began on 28th December 2005 and is to be completed by end of 2007. When completed, the processing capacity of the Port will hit 50 million tons.

## 3. New Projects

### (1) Project of No. 5 Cold-rolled Strip Steel

This is a integral unit of 1730mm pickling mill with finishing devices. When completed, the capacity is expected to reach 1.95 million tons. The project began on the 20th January 2006 and is expected to be completed in 2008.

### (2) UOE Project

This is a production line of welded pipe with heavy calibre, with a capacity of annual output of 500,000 tons. The line, equipped with U-O shaping technology, will be used to produce high performance oil/gas pipes. The project began on the 9th February 2006 and is expected to be completed at the end of 2007.

### (3) No. 4 Power Generating Set Project

This is a new 350 MW generating set, which began on the 29th April 2006 and is expected to be completed in May, 2008.

### (4) Project of Stainless Cold-rolling Mill

The first stage of the project comprises a hot and acid pickling annealing unit, a bell furnace, and a continuous pickling line. When completed, the capacity is expected to reach 0.7 million tons of acid-pickling stainless hot-rolled coils and 1.15 million tons of acid-pickling hot-rolled carbon steel oils. The project began on the 26th April 2006 and is expected to be completed at the end of 2007.

## VII. Board of Directors' Report

### 6. Routine Work of Board of Directors

#### (1) Meetings and resolutions

- (i) The 14th meeting of the Second Board of Directors was held on 28th March 2006, and the public announcement was posted in *China Securities News*, *Shanghai Securities News* and *Securities Times* dated on 29th March 2006.
- (ii) The 15th meeting of the Second Board of Directors was held on 28th April 2006, and the public announcement was posted in *China Securities News*, *Shanghai Securities News* and *Securities Times* dated on 29th April 2006.
- (iii) The 1st meeting of the Third Board of Directors was held on 17th May 2006, and the public announcement was posted in *China Securities News*, *Shanghai Securities News* and *Securities Times* dated on 18th May 2006.
- (iv) The 2nd meeting of the Third Board of Directors was held on 28th August 2006, and the public announcement was posted in *China Securities News*, *Shanghai Securities News* and *Securities Times* dated on 29th August 2006.
- (v) The company informed by email and regular mail about the interim Board meeting and the meeting materials on 14th September 2006, and the resolution of the meeting was unanimously approved by the Directors in form of written vote. The public announcement was posted in *China Securities News*, *Shanghai Securities News* and *Securities Times* dated on 23rd September 2006.
- (vi) The 3rd meeting of the Third Board of Directors was held on 27th October 2006, and the public announcement was posted in *China Securities News*, *Shanghai Securities News* and *Securities Times* dated on 28th October 2006.
- (vii) The 4th meeting of the Third Board of Directors was held on 15th December 2006, and the public announcement was posted in *China Securities News*, *Shanghai Securities News* and *Securities Times* dated on 19th December 2006.

#### (2) Board of Directors' implementation of resolutions of the General Meeting

According to the resolutions passed at the 2005 Shareholders' General Meeting held on 17th May 2006, the proposed profit appropriation for 2005 is as follows:

All shareholders are entitled to a cash dividend of Rmb0.32 per share (taxes included), for a total dividend payout of Rmb5.604 billion. Net dividends (after tax) received by holders of free-floating shares were Rmb0.288 per share for individual shareholders and Rmb0.32 (taxes included) per share for state and institutional investors.

Details of the dividend distribution were published in the *China Securities News*, *Shanghai Securities News* and *Securities Times* of 19th May 2006. The final share registration date for dividend entitlement was 24th May 2006, with the ex-dividend date set at 25th May 2006 and dividend payout date on 31st May 2006. All shareholders, as registered with the China Securities Depository and Clearing Co., Ltd.'s Shanghai Branch after the market closed on 24th May 2006, were entitled to such cash dividends.

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## 7. 2006 Proposed Profit Appropriation

Non-consolidated net profit in 2006 totaled Rmb13, 338,846,752.65. For the Company's long-term sustainable development and the conception of 'maximizing shareholders' value', the Board of Directors proposes the following profit appropriating scheme for the year of 2006:

- (1) Ten per cent of the net profit, or Rmb1,333,884,675.27, will be allocated as statutory earnings reserves;
- (2) Ten per cent of the net profit, or Rmb1,333,884,675.27 will be allocated as discretionary earnings reserves;
- (3) With the retained earnings of Rmb13,680,726,945.49 (as at the beginning of the year) and the 2005 cash dividend payment of Rmb5,603,840,000.00, distributable profits at the end of 2006 were Rmb18,747,964,347.60;
- (4) The board of directors has proposed a cash dividend payout of Rmb3.5 per 10 shares (taxes included) to all shareholders registered before the deadline indicated in the dividend payout announcement, with total of dividend payable of Rmb 6,129,200,000.00.
- (5) Shares from public capital reserves were not taken into account.

## VIII. Board of Supervisors' Report

### 1. Summary of the Supervisors' Performance

- (i) In 2006, the board of supervisors labored to ensure that the Company's operations, financial auditing, and performance by the directors and senior managers are carried out in strict compliance with the rules and regulations set in the *Company Law* and the *Charter of the Company*. The board of supervisors attended the 14th and 15th meetings of the Second Board of Directors and the 1st, 2nd, 3rd and 4th meetings of the new Board to supervise the convening of the board meetings and ensure that voting procedures on resolutions conform to relevant laws, regulations and the *Charter of the Company*.
- (ii) The Board of Supervisors was convened for the 13th and 14th, of the Second Board of Supervisors and the 1st, 2nd, 3rd and 4th meetings of the new Board in the reported period. In line with its duty the Board expressed its opinion on the legality, procedures and financial impact of the resolutions proposed by the board of directors, and made public announcements of the resolutions accordingly. The details of the meetings by the boards of supervisors are listed as follows:
  - (1) On March 28, 2006, the Second Board of Supervisors held its 13th meeting in Shanghai and passed the following resolutions:

Proposal for Supervisors' Review of the "Report on Asset Loss of the Company in 2005" and the "Proposal for Provisions for Impairment Losses of Assets of the Company as at the End of 2005";

Proposal for Supervisors' Review of "the Report of the 2005 Annual Accounting Proposal of the Company" and the "Annual Profit Appropriation Proposal of the Company";

Proposal for Supervisors' Review of the "2005 Annual Report and its Abstract";

2005 Board of Supervisors' Report;

2005 Outside Supervisors' Report;

Proposal for Supervisors' Review of the "2006 Budget of the Company";

Proposal for Supervisors' Review of the "Estimation of Day-to-Day Related Transactions of the Company in 2006";

Proposal for Supervisors' Review of the "Proposal of Revision of the *Chart of the Company*";
  - (2) On April 28, 2006, the Second Board of Supervisors held its 14th meeting in Shanghai and passed the following resolutions:

Proposal for Supervisors' Review of the "Proposal for Provisions for Impairment Losses of Assets of the Company as at the End of the First Quarter of 2006";

Proposal for Supervisors' Review of the 2006 Report of the First Quarter;

Proposal for Supervisors' Review of the "Proposal of Revision of the Chart of the Company";

Proposal of Re-election of the Board of Supervisors of the Company;

Summary of the Work of the Second Board of Supervisors of the Company;
  - (3) On May 17, 2006, the Third Board of Supervisors held its 1st meeting in Beijing and passed the following resolutions:

Proposal for Electing the Chairperson of the Third Board of Supervisors of the Company;

- (4) On August 28, 2006, the Third Board of Supervisors held its 2nd meeting in Shanghai and passed the following resolutions:
- Proposal for Supervisors' Review of the "Proposal for Provisions for Impairment Losses of Assets of the Company as at the End of the First Half of 2006";
- Proposal for Supervisors' Review of the "Interim Report of 2006";
- Proposal for Supervisors' Review of the "Proposal for Management of the Company as Guarantor";
- Proposal for Supervisors' Review of the "New Related Transactions of the Company in 2006";
- (5) On October 27, 2006, the Third Board of Supervisors held its 3rd meeting in Shanghai and passed the following resolutions:
- Proposal for Supervisors' Review of the "Proposal for Provisions for Impairment Losses of Assets of the Company as at the End of the Third Quarter of 2006";
- Proposal for Supervisors' Review of the "Report of the Third Quarter of 2006";
- Proposal for Supervisors' Review of the "Proposal for Management of Related Transactions of the Company";
- (6) On December 15, 2006, the Third Board of Supervisors held its 4th meeting in Shanghai and passed the following resolutions:
- Proposal for Supervisors' Review of the "Proposal for A-share Incentive Plan of the Company";
- Proposal for Supervisors' Review of the "New Related Transactions of the Company in 2006";

## 2. Opinions on the Company's Operations in 2006

- (i) The Company has a well-structured internal control system and has followed the proper legal proceedings in making its decisions and formulating its policies. It has complied strictly with relevant rules and laws, and regulated the Company's operations accordingly. Board directors and senior managers have behaved responsibly and assiduously in performing their duties and carrying out the resolutions passed by the board and the shareholders alike. None of the directors or senior managers was found to have breached any rules, laws and regulations of the country and the *Chart of the Company* or conducted any deed that has harmed the Company's interest.
- (ii) The Company was in good and solid financial health in 2006. Its sound financial management and internal control system ensured smooth and normal manufacturing and production operations. Its 2006 financial statements are a true reflection of the financial condition and operating results of the Company, and the standard unqualified opinion issued by Ernst & Young Hua Ming in the auditors' report is fair and objective.
- (iii) The company has not involved in any fund-raising activity in the period reported;
- (iv) The company has not involved in any substantial acquisition or disposal of assets in the period reported;
- (v) In the period reported, the related party transactions were carried out according to *Related Party Transaction Management Methods* of Baoshan Iron & Steel Co., Ltd. at fair prices and without any damage to the Company's benefits.

## IX. Significant Events

### 1. Legal Proceedings

The Company was not involved in any material litigation or arbitration proceedings in the period reported.

### 2. Acquisition and Disposal of Major Assets

In the period reported, the Company was not involved in any substantial assets acquisition, disposal, takeover, or merge.

### 3. Major Related Party Transactions

#### (i) Day-to-day related party transactions

The major related parties of the Company are legal persons controlled by Baosteel Group. The transactions conducted between the Company and its major related parties in the reported period included:

#### (1) Sales of products and purchases of services

Unit: Rmb million

Affiliates	Transactions	Pricing	Amount
Baosteel Group Enterprise Development Corp.	Sales of steel products, raw materials and fuels, supplementary materials, etc.	Market	3,786
Baosteel Group Shanghai No. 1 Steel Co., Ltd.	Sales of steel products and energy	Market	524
Baosteel Trading Co., Ltd.	Sales of raw materials and fuels	Market	1,316
Baosteel Group Shanghai No. 2 Steel Co., Ltd.	Sales of steel products and raw materials and fuels	Market	628
Baosteel Group Shanghai Meishan Iron & Steel Co., Ltd.	Sales of steel products, raw materials and fuels, supplementary materials, etc.	Market	1,800
Baosteel Group Shanghai Pudong Iron & Steel Co., Ltd.	Sales of steel products, raw materials and fuels, supplementary materials, etc.	Market	2,226
Sub-total of sales			10,280
Baosteel Group Enterprise Development Corp.	Purchase of steel products and supplementary materials	Market	967
Baosteel Group Shanghai Meishan Iron & Steel Co., Ltd.	Purchase of raw materials and fuels and supplementary materials	Market	791
Baosteel Group Shanghai Pudong Iron & Steel Co., Ltd.	Purchase of steel products	Market	1,267
Baosteel Group Shanghai No. 1 Steel Co., Ltd.	Purchase of steel products and energy	Market	1,137
Shanghai Baosteel Engineering & Technological Co., Ltd.	Purchase of equipment and supplementary materials		492
Sub-total of purchase			4,654
Baosteel Group Enterprise Development Corp.	Comprehensive logistics, project installation services, equipment examination & maintenance service, and transportation services	Negotiation	942
Baosteel Group Shanghai No. 1 Steel Co., Ltd.	Comprehensive logistics, project installation services, equipment examination & maintenance service, and transportation services	Negotiation	476
Baosteel Group Shanghai Meishan Iron & Steel Co., Ltd.	Comprehensive logistics, project installation services, equipment examination & maintenance service, and transportation services	Negotiation	803
Shanghai Baosteel Equipment Examination & Maintenance Co., Ltd.	Project installation services & equipment examination & maintenance service	Negotiation	425
Sub-total of services			2,646

The sales above accounted for 6.5% of the Company's revenues from its principal businesses in 2006; purchases and services received took up 3.6% and 2.1% of cost of goods sold respectively.

All transactions were settled either by cash or checks.

#### (2) Financial services

Baosteel Group Finance Co., Ltd. (hereafter referred to as Finance Co.), a non-bank financial company with the Baosteel Group (with 35.2% of the shares), and Company's sole subsidiaries Baosteel International (with 40.1% of the shares) and Shanghai Baosteel Pudong Intl. Trade Co., Ltd. (with 20% of the shares) as joint-share owners, was established for central management of the funds of the Company so as to raise the efficiency of fund use. It provides a comprehensive service of internal accounting settlement, fund deposit and loan, short-term capital financing, investment and fund-raising.

In the period reported, the Finance Co. provided, at the Rmb interest rate as set by the People's Bank of China, a total of Rmb 1,220 million to Baosteel Group's controlled companies, with outstanding loan of 670 million and a total interest income of Rmb 30 million. The total deposit from the Group and its controlled companies reached Rmb 58,240 million, with an outstanding of Rmb 20,190 million and an interest payment of Rmb 300 million.

In the reported period, the Finance Co. as an entrustee managed the assets of Baosteel Group as regarding repurchase of bonds with fixed and assured yield. The biggest trust amount reached Rmb 3.69 billion with Rmb 10 million asset management yield.

(3) **Necessity of related party transactions**

Based on the mutual maximum profits and operation efficiency, the Company and the related parties choose each other so that both can make the best of each other's advantages in professional collaboration, each becoming more competitive. The related transactions between the Company and the related parties are expected to continue.

(ii) **Transfer of assets or shareholdings**

The Company was not involved in any related transaction due to transfer of assets or shareholdings in the reported period.

(iii) **Claims, liabilities and guarantees**

- A. Claims and liabilities arise from day-to-day related party operations and transactions that result in trade receivables and payables, as well as from long-term dues to the holding company for acquisition of assets.
- B. Guarantees: In 2006, the Company had US\$2.504 million, Euro28.752 million and 2.29 billion Japanese yen in long-term foreign currency borrowings that were guaranteed by Baosteel Finance.
- The claims, liabilities and guarantees above didn't shed huge impact on the Company's operations.

(iv) **Fund appropriations and their solutions**

The Company was not involved in any fund appropriation in the reported period.

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## 4. **Major Contracts and Performance**

(i) **Trusteeships, contracts or leases.**

The Company was not involved in any major trusteeships, contracts or leases in the reported period.

(ii) **Guarantees**

Refer to X 3.

(iii) **Major entrusted financing**

The Company was not involved in any major entrusted financing in the reported period.

(iv) **Other major contracts**

The Company was not involved in any major contracts in the reported period.

## IX. Significant Events

### 5. Company and Shareholder (with over 5% stake) Commitments

#### 1) The holding company undertook the following two commitments as at the establishment of the Company:

- (i) All related party transactions will be carried out in compliance with relevant laws, regulations and rules set by the authorities and will not damage the legitimate interest of the Company nor its minority shareholders.
- (ii) The Group will not directly participate in any business activity or directly own an interest in any business activity or entity that poses a competition to the Company. However, the Group can maintain its existing interest in other company (companies), as well as manage and develop this business which may or may not be in competition with the Company.

In addition, on June 13, 2001, and September 6, 2002, the Group further pledged to uphold those two commitments after the Company's acquisition of the assets related to construction of its phase 3 project and all remaining assets thereof. These commitments will stay in force under two conditions:

(a) The Company is listed on the Hong Kong Stock Exchange and domestic stock exchange of China; and

(b) The Group owns no less than 30% of the Company's issued shares.

The Group did not commit any breach of promise to the Company in the period covered. All these commitments were published on *China Securities News*, *Shanghai Securities News* and *Securities Times* on 21st June 2001 and 12th September 2002 and the official website of Shanghai Stock Exchange (<http://www.sse.com.cn>) as well.

#### 2. Commitments made in Issuance Prospectus by the Group

- (i) The Company has the right to acquire the holding assets and businesses of Baosteel Group which may be in competition with it;
- (ii) The Company shall enjoy the priority of similar business opportunities acquired by Baosteel Group, who will not invest until the Company gives up the commercial opportunities;
- (iii) The Group is committed to helping dealing with the relevant property certificates for buildings and lands after the Company completed the acquisitions;
- (iv) According to the estimated value of state-allocated land in the land administration departments and in compliance with the rules on transfer land fee by Shanghai Municipal Government and Majishan Government, the Company is predicted to pay no more than Rmb 563 million for the total transfer land fee for dealing with the transfer procedures of state-allocated land mentioned above. The Group has undertaken the following commitment: in the event of the total transfer land fee exceeding Rmb 563 million for the procedures, the Group will fully cover the exceeding amount for the Company in time.
- (v) The estimated value for empty transferred land totals about Rmb 1.42 billion, taking up 34% of the total estimated land value. The Group has undertaken the following commitment: if the Company or its affiliated companies have to pay or add the transfer land fee for changing the empty transfer land into state transfer land that can be freely transferred and mortgaged, The Group agrees to fully compensate the Company for the land transfer fees.
- (vi) The estimated value of the collective-owned land totals about Rmb 10 million, accounting for 0.2% of the total estimate. The Group has undertaken the following commitment: if the Company or its affiliated companies fail to legally occupy and utilize the collective-owned land because such land hasn't undertaken the state-owned land transfer procedures, The Group will cover all the economic losses for the Company or its affiliated companies.

The Company did not commit any breach of the promises in the period covered. All these commitments were publicly posted on official website of the Shanghai Stock Exchange (<http://www.sse.com.cn>) in April 2005.

### 3. Commitments the Group undertook during untradable share reform

- (i) Baosteel agreed to and would implement the untradable share reform resolution approved by the shareholders' general meeting. According to the resolution, the Group pays consideration to shareholders of tradable shares so that Baosteel's shares can be entitled to circulation. Baosteel Group will cover the relevant depository procedures at China Securities Depository and Clearing Co., Ltd.'s Shanghai Branch for the needed shares to ensure the consideration payment.
- (ii) The Group promised that, within 2 months after the untradable share reform was approved at the shareholders' general meeting, if the price was lower than Rmb 4.53 per share, the Group would increase the general public shares by centralized price bidding at Shanghai Stock Exchange with a total investment of no more than Rmb 2 billion. Such a commitment would remain valid within the 2 months unless the price didn't become lower than Rmb4.53 per share or the Rmb 2 billion was used up.

Within 6 months after the shareholding increase program was fulfilled, the Group shall not sell the increased shares and would disclose the relevant information.

The Group bought the Company's shares at the secondary market from 25th August 2005 on. By 21th September 2005, the fund of Rmb 2 billion had been used up, achieving an increase of 446,565,849 shares and the relevant disclosure was published on 22nd September 2005.

- (iii) In order to further the non-tradable share reform program so as to prevent the Company's shares from irrational fluctuating and protect the interests of the investors, Baosteel Group made further efforts by promising that, in case that the shares of the Company drop to a level below 4.53 per share six months after the above-mentioned two-month period, the Group shall inject another sum of no more than Rmb 2 billion in the aggregation, together with the remaining of the first injection if it has not been used up, to purchase the Company's shares by means of competitive pricing at the Stock Exchange of Shanghai until the promised sum has been used up or the Company's shares rise at a level above 4.53 per share. The commitment shall be fulfilled on the condition that the China Securities Regulatory Commission exempts the Group from the duties of compulsive acquisition offer of the company's stocks and that the non-tradable share reform program is approved by the Company's Shareholders' General Meeting.

Within 6 months after the shareholding increase plan was fulfilled, the Group shall not sell the increased shares and would disclose the relevant information.

The above mentioned commitments were published on *China Securities News*, *Shanghai Securities News* and *Securities Times* of July 30, 2005.

The Group bought the Company's shares at the secondary market from 24th October 2005 on. By 5th January 2006, the fund of Rmb2 billion had been used up, achieving a total increase of 491,780,281 shares and the relevant disclosure was published on 6th January 2006.

- (iv) In complying with the regulations in *Notice of the China Securities Regulatory Commission on Piloting the Shareholder Structure Reform of Listed Companies*, the Group shall not trade or transfer the holding shares at least within 12 months after getting the circulation right and would not start trading until 24 months later. Within 12 months after the 24-month period expires, the shares to be traded at stock exchanges shall not exceed 5% of the total shares at a price no less than Rmb 5.63 per share. Within three years after the company's shares got the circulation right, The Group's shareholding would not be lower than 67% of the total stock issuance. Nevertheless, Baosteel's increased shares after implementing non-tradable share reform will not be subject to such limits in trading or transferring.

The aforementioned commitments were published on *China Securities News*, *Shanghai Securities News* and *Securities Times* and the official website of Shanghai Stock Exchange (<http://www.sse.com.cn>) of June 28, 2005.

The Group didn't commit any breach of the promises in the covered period.

### 4. Changes in shares not subject to selling restrictions held by shareholders holding 5% of the original non-tradable shares

Shareholder	Shares not subject to selling restrictions held as on the listing day of shares subject to selling restriction (10 thousand shares)	Increase/decrease (10 thousand shares)	Shares not subject to selling restrictions held as at the end of the period reported (10 thousand shares)	Cause for change
Baosteel Group	0	93834.6130	93834.6130	Hold more shares not subject to selling restrictions of the Company , as promised

## IX. Significant Events

### 6. Engagement and/or Termination of Auditor's Service

The services of the accounting firm Ernst & Young Hua Ming were retained by the Company this year. The compensation paid to the accounting firm, which has served the Company for the past seven years, is detailed below:

- (i) The form or amount of the compensation payable to the accounting firm for services rendered to the Company is determined and subject to approval at the Shareholders' Meeting. Meanwhile, compensation for auditing services rendered to the Board of Directors is determined by the Board. Independent directors gave their unanimous consent to the compensation for the accounting firm.
- (ii) As passed by 2005 Annual Shareholders' Meeting, the auditing fees payable to Ernst & Young Hua Ming in 2006 was Rmb 2.75 million. The auditing fees for the 2005 Annual Report were Rmb 2.66 million.  
  
Expenses and costs related to auditing service and advanced by the accounting firm are reimbursed and borne by the Company.
- (iii) Signatory auditors to the Company's 2006 Financial Statements are Ge Ming and Zhang Xiaodong, who also signed on the previous year's statement.

- ### 7. Neither the Company, nor the Board of Directors and any of its director, was the subject of an investigation by the China Securities Regulatory Commission in 2006, neither were they punished or penalized or cited by the commission, or openly denounced by any administrative department or Shanghai Stock Exchange for any wrongdoing.

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## 8. Internal Control

Ever since Baosteel's establishment, the internal control system of the Company has been improved as efforts have been made to better the management as a whole. Built in a corporate culture focused on credit and honesty, the internal control system helps the measures taken by the management to form a central business system of production, marketing and management. The sound and effective control system has been a guarantee for the truth, the accuracy and the integrity of the contents of the financial reports as well as for interests of the Company in terms of production, management and further development.

To better the internal control system, the Board of Directors approved in 2006 the Company's Methods for Internal Control System in accordance with *Guidelines of Shanghai Stock Exchange for the Internal Control of Listed Companies*. The Methods identified the specific duties and responsibilities for internal control: The Board of Directors is in charge of the system as regarding establishment, implement, improvement and supervision, with the Board's Auditing Committee responsible for checkup and evaluation of the implement of internal control measures; the management team of the Company is in charge of the specific requirements of the system and authorization and supervision so as to help better the system as a whole and the efficiency in practice by entitling a specific department to promote the work. As a result, the internal control system in the Company has been effectively implemented.

In the past year, the duties and responsibilities were further classified among the departments and the procedures were made clearer. Altogether 11 categories of documents, which involve production, management and business, were revised, of which more than 300 were documents at the Company's level. Checkups by business department itself, by administrative departments, and the auditing department were also conducted to find out what needed to be done to improve the efficiency of the internal control system.

In the year of 2007, well-known international consulting firms have been invited to evaluate the internal control system of the Company. The evaluation work started in March and it will involve the Company, sub-companies and subsidiaries such as Baosteel International and Meisteel. The purpose is to evaluate the internal system at the management level and at level of business procedure so as to better the internal control system and improve the self-evaluating system of the Company and to make the Company more competitive in risk management.

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## 9. Progress in A-share Incentive Plan and its Impact on Financial and Business Performance

The A-share Incentive Plan of Baoshan Iron & Steel Co., Ltd. has been approved by the 4th meeting of the Third Board of Directors and made public on December 19, 2006. It is now awaiting the approval of the State-owned Assets Supervision and Administration Commission of the State Council (SASAC) and the China Securities Regulatory Commission (CSRC), which will be followed by the approval of the Shareholder's Meeting of the Company.

As the plan is waiting to be approved, it has had no impact on the gains and losses of the Company. When the plan is approved and when the performance of the Company meets the requirements as indicated in the plan, a proportion of the net profit of the Company will be appropriated as equity incentive shares while the cost will be booked in accordance with relevant accounting standards. As the amount of incentive share will be linked to the performance of the Company and will not exceed a certain portion of the remuneration of the receiver, the annual profit of the Company will not be influenced significantly.

The plan is set in accordance with the strategy of the Company to strengthen its competitiveness and to invite outstanding performance among similar companies at home and abroad. The purpose of the plan is to better the governance and incentive and restraint mechanisms for the healthy and sustainable growth of the Company by offering incentives to the receivers so as to synchronize the interests of them and shareholders in a long run.

## IX. Significant Events

### 10. Index of Important Announcements

Item	Disclosure date
Baoshan Iron & Steel's Announcement of Baosteel Group Corporation's Implementation of Shareholding Increase	2006-1-6
Notice for Change of Correspondence of Baoshan Iron & Steel Co., Ltd.	2006-3-17
Announcement of the Resolutions of the 14th Meeting of Second Board of Directors and Announcement on Convening Shareholders' Meeting of Baoshan Iron & Steel Co., Ltd.	2006-3-29
Announcement of the Estimated Day-to-Day Related Transactions of 2006 of Baoshan Iron & Steel Co., Ltd.	2006-3-29
Announcement of the Resolutions of the 13th Meeting of Second Board of Supervisors of Baoshan Iron & Steel Co., Ltd.	2006-3-29
Notice of Online Release of the 2005 Performance of Baoshan Iron & Steel Co., Ltd.	2006-3-29
Notice of Online Release of the Performance of Baoshan Iron & Steel Co., Ltd. in the First Quarter of 2006	2006-4-26
Announcement of the Resolutions of the 15th Meeting of Second Board of Directors of Baoshan Iron & Steel Co., Ltd.	2006-4-29
Announcement of the Resolutions of the 14th Meeting of Second Board of Supervisors of Baoshan Iron & Steel Co., Ltd.	2006-4-29
Notice of New Interim Proposals to the 2005 Annual Shareholders' Meeting	2006-4-29
Announcement of the Resolutions of the 2005 Annual Shareholders' Meeting of Baoshan Iron & Steel Co., Ltd.	2006-5-18
Announcement of the Resolutions of the 1st Meeting of Third Board of Directors of Baoshan Iron & Steel Co., Ltd.	2006-5-18
Announcement of the Resolutions of the 1st Meeting of Third Board of Supervisors of Baoshan Iron & Steel Co., Ltd.	2006-5-18
Announcement of Implementing 2005 Annual Dividends Appropriation of Baoshan Iron & Steel Co., Ltd.	2006-5-19
Notice of Exercise Price Change of JTBI Stock Warrants of Baoshan Iron & Steel Co., Ltd.	2006-5-19
Notice Regarding Issue of the Exercise of JTBI Stock Warrants of Baoshan Iron & Steel Co., Ltd.	2006-7-18
The Second Notice Regarding Issue of the Exercise of JTBI Stock Warrants of Baoshan Iron & Steel Co., Ltd.	2006-8-1
The Third Notice Regarding Issue of the Exercise of JTBI Stock Warrants of Baoshan Iron & Steel Co., Ltd.	2006-8-10
Notice of the Exercise of JTBI Stock Warrants of Baosteel Group Corporation	2006-8-21
Notice of the Delisting of JTBI Stock Warrants of Baosteel Group Corporation	2006-8-22
Notice of the Exercise of JTBI Stock Warrants of Baosteel Group Corporation	2006-8-25
Notice of Online Release of the Performance of Baoshan Iron & Steel Co., Ltd. in the Interim Quarter of 2006	2006-8-25
Notice of the Exercise of JTBI Stock Warrants of Baosteel Group Corporation	2006-8-29
Announcement of the Resolutions of the 2nd Meeting of Third Board of Directors of Baoshan Iron & Steel Co., Ltd.	2006-8-29
Notice of New Related Transactions in 2006 of Baoshan Iron & Steel Co., Ltd.	2006-8-29
Announcement of the Resolutions of the 2nd Meeting of Third Board of Supervisors of Baoshan Iron & Steel Co., Ltd.	2006-8-29
Announcement of Results of the Exercise of JTBI Stock Warrants of Baosteel Group Corporation	2006-8-31
Notice of Delisting of the JTBI Stock Warrants of Baosteel Group Corporation	2006-9-1
Announcement of the Resolutions of the 1st Interim Meeting of Third Board of Directors of Baoshan Iron & Steel Co., Ltd.	2006-9-23
Notice of Online Release of the Performance of Baoshan Iron & Steel Co., Ltd. in the Third Quarter of 2006	2006-10-26
Announcement of the Resolutions of the 3rd Meeting of Third Board of Directors of Baoshan Iron & Steel Co., Ltd.	2006-10-28
Announcement of the Resolutions of the 3rd Meeting of Third Board of Supervisors of Baoshan Iron & Steel Co., Ltd.	2006-10-28
Announcement of the Resolutions of the 4th Meeting of Third Board of Directors of Baoshan Iron & Steel Co., Ltd.	2006-12-19
Announcement of the Resolutions of the 4th Meeting of Third Board of Supervisors of Baoshan Iron & Steel Co., Ltd.	2006-12-19
Notice of New Related Transactions in 2006 of Baoshan Iron & Steel Co., Ltd.	2006-12-19

All these announcements were publicly posted on *China Securities News*, *Shanghai Securities News* and *Securities Times* and the website of Shanghai Stock Exchange: <http://www.sse.com.cn>.

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## 11. Other significant matters

No significant event, as defined in Article 67 of the *Securities Law* or Article 17 of the *Manual on Information Disclosure by Public Companies*, or any other matter judged and deemed as a significant event by the Board of Directors, occurred in 2006.

## X. 2006 Financial Statements

1. Auditors' Report	45
2. Audited Financial Statements	
Consolidated Balance Sheet	46-47
Consolidated Income Statement and Profit Appropriation Statement	48
Consolidated Cash Flow Statement	49-56
Consolidated Statement of Changes in Shareholders' Equity	57
Balance Sheet	58-59
Income Statement and Profit Appropriation Statement	60
Cash Flow Statement	61-64
Statement of Changes in Shareholders' Equity	65
Notes to the Financial Statements	66-134
3. Notes	135-136
4. Difference Adjustment Table for Shareholders' Equity between the Old and New Accounting Standards and Auditor's Opinion	137-141

# Auditors' Report

Ernst & Young Hua Ming  
(2007) Audit No. 60428378\_B01

To the shareholders of Baoshan Iron & Steel Company Limited (the "Company")

We have audited the accompanying consolidated balance sheet of Baoshan Iron & Steel Company Limited (the "Company") and its subsidiaries (collectively referred to as the "Group") as of 31st December 2006 and the related consolidated income statement, consolidated statement of changes in equity and consolidated cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

## 1. Management's Responsibility for the Financial Statements

The management is responsible for the preparation and fair presentation of these financial statements in accordance with the *Accounting Standards for Business Enterprises and China Accounting System for Business Enterprises*. This responsibility includes: (i) designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; (ii) selecting and applying appropriate accounting policies; and (iii) making accounting estimates that are reasonable in the circumstances.

## 2. Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with the *Standards on Auditing for Certified Public Accountants*. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

## 3. Opinion

In our opinion, the financial statements give a true and fair view of the financial position of the Company and of the Group as of 31 December 2006, and of its financial performance and its cash flows for the year then ended in accordance with the *Accounting Standards for Business Enterprises and China Accounting System for Business Enterprises*.

Ernst & Young Hua Ming  
Beijing P.R.China

Certified Public Accountants  
Registered in P.R.China  
Ge Ming  
Zhang Xiaodong  
29th March 2007

## Consolidated Balance Sheet

31st December 2006

(Rmb)

Assets	Note 5	December 31, 2006	December 31, 2005
Current Assets			
Cash and cash equivalents	(1)	5,337,491,762.14	4,857,302,510.99
Short-term investment	(2)	11,503,391.54	27,014,232.79
Notes receivables	(3)	5,200,575,938.66	8,488,968,976.41
Dividends receivables	(4)	-	66,058,481.38
Trade receivables	(5)	5,181,926,170.93	4,770,427,543.74
Other receivables	(6)	851,974,301.01	475,153,601.35
Payment in advance	(7)	3,506,685,711.84	3,358,628,764.24
Inventories	(8)	31,514,549,913.06	25,046,290,143.02
Deferred expenses	(9)	6,589,462.93	8,281,300.09
Total current assets		51,611,296,652.11	47,098,125,554.01
Long-term Investment			
Long-term equity investment	(10)	2,712,666,848.89	2,610,103,913.44
Long-term debt investment	(10)	-	261,333,413.17
Total long-term investment		2,712,666,848.89	2,871,437,326.61
Incl.: consolidation difference	(10)	387,076,608.08	518,435,843.43
Fixed Assets	(11)		
Gross fixed assets		178,264,016,098.50	167,200,278,728.25
Less: Accumulated depreciation		96,366,993,175.81	87,408,995,574.69
Fixed assets before revaluation		81,897,022,922.69	79,791,283,153.56
Less: Provision for impairment losses of assets		29,753,257.12	51,942,727.42
Net fixed assets		81,867,269,665.57	79,739,340,426.14
Project materials	(12)	568,800,785.71	669,404,817.80
Construction-in-progress	(13)	11,897,996,571.43	8,818,232,607.56
Total fixed assets		94,334,067,022.71	89,226,977,851.50
Intangible Assets and Other Assets			
Intangible assets	(14)	1,351,196,378.61	1,298,102,967.04
Long-term deferred expenses	(15)	303,741,721.05	414,868,636.48
Other long-term receivables		-	445,711,168.49
Other long-term assets		10,798,489.64	8,713,514.60
Circulating right of non-tradable share reform	(16)	7,949,489.18	-
Total of Intangible and Other Assets		1,673,686,078.48	2,167,396,286.61
Deferred Taxes			
Deferred tax debits	(17)	727,862,109.21	660,299,247.07
Total assets		151,059,578,711.40	142,024,236,265.80

The accompanying notes on pages 81 to 180 constitute an integral part of the Financial Statements.

## Consolidated Balance Sheet (Continued)

December 31, 2006

(Rmb)

Liabilities & Shareholders' Equity	Note 5	December 31, 2006	December 31, 2005
Current Liabilities			
Short-term loans	(18)	19,972,694,700.06	10,777,078,405.58
Notes-payable	(19)	1,691,587,296.03	7,511,700,423.44
Trade payables	(20)	12,084,960,713.41	10,617,071,865.98
Receipts in advance	(21)	7,204,746,856.83	5,788,680,645.72
Accrued payroll		918,487,533.76	582,802,717.52
Staff welfare payable		346,955,112.22	250,841,715.98
Dividends payable	(22)	518,764,956.41	575,028,215.45
Taxes payable	(23)	1,073,504,586.19	(342,302,962.52)
Fees due to governments	(24)	79,845,085.58	72,663,605.06
Other payables	(25)	1,106,109,285.79	938,543,189.97
Accrued expenses	(26)	385,187,142.69	164,493,982.26
One-year due long-term liabilities	(28)	358,454,970.73	2,416,567,015.41
Payables to holding company		125,010,000.00	125,010,000.00
One-year due long-term payables to holding company	(29)	1,400,000,000.00	3,200,000,000.00
Total current liabilities		47,266,308,239.70	42,678,178,819.85
Long-term Liabilities			
Long-term loans	(28)	15,094,892,880.38	16,194,973,037.72
Long-term payables		1,172,767.14	1,239,072.91
Special payables		63,705,149.85	51,206,638.06
Other long-term payables		-	834,948,673.89
Long-term payables to holding company	(29)	1,611,218,602.02	3,130,290,795.41
Total long-term liabilities		16,770,989,399.39	20,212,658,217.99
Deferred Taxes			
Deferred tax credits	(17)	147,499,016.73	206,482,383.03
Total liabilities		64,184,796,655.82	63,097,319,420.87
Minority Shareholders' Equity		4,914,236,130.47	4,451,667,026.77
Shareholders' Equity			
Capital	(30)	17,512,000,000.00	17,512,000,000.00
Capital reserves	(31)	32,803,940,232.87	32,722,971,425.12
Earnings reserves	(32)	14,758,576,683.52	11,697,079,788.16
Incl.: public welfare fund		-	4,157,679,368.40
Retained earnings	(33)	16,936,323,133.48	12,591,395,511.37
Incl.: Dividends proposed by Board of Directors	(34)	6,129,200,000.00	5,603,840,000.00
Foreign currency translation difference		(50,294,124.76)	(48,196,906.49)
Total shareholders' equity		81,960,545,925.11	74,475,249,818.16
Total liabilities & shareholders' equity		151,059,578,711.40	142,024,236,265.80

The accompanying notes on pages 66 to 134 constitute an integral part of the Financial Statements.

The Financial Statements as presented on pages 46 to 142 are signed by:

Legal representative: Xu Lejiang

Financial controller: Chen Ying

Head of finance department: Wang Mingdong

## Consolidated Income Statement and Profit Appropriation Statement

2006

(Rmb)

	Note 5	2006	2005
Revenues from principal businesses	(35)	157,791,465,606.60	126,608,361,546.73
Less: Cost of sales	(36)	129,228,902,688.22	99,981,656,847.74
Business tax and surcharges	(37)	669,486,338.87	695,241,075.98
Gross profit from principal businesses		27,893,076,579.51	25,931,463,623.01
Add: Gross profit from other businesses		24,416,200.23	117,762,785.12
Less: Operating expenses		2,238,967,902.33	1,606,549,180.38
Administration expenses	(39)	5,388,150,520.72	5,095,363,688.68
Financial expenses	(40)	1,306,365,346.80	1,043,608,848.27
Operating profit		18,984,009,009.89	18,303,704,690.80
Add: Investment income	(41)	325,367,320.37	181,356,450.65
Subsidies income		44,735,420.40	25,080,279.15
Non-operating income		50,046,070.81	65,754,604.58
Less: Non-operating expenses		396,424,048.43	265,122,471.97
Pre-tax profit		19,007,733,773.04	18,310,773,553.21
Less: income tax expenses		5,545,276,953.54	5,776,566,923.94
Losses and gains of minority shareholders		452,192,302.03	(131,322,362.18)
Net profit		13,010,264,517.47	12,665,528,991.45
Add: Retained earnings at beginning of the year		12,591,395,511.37	9,966,453,299.90
Distributable profit		25,601,660,028.84	22,631,982,291.35
Less: Transfer to statutory earnings reserve	(33)	1,650,867,940.40	1,529,679,670.20
Transfer to statutory public welfare fund	(33)	-	1,517,813,287.41
Transfer to reserve fund	(33)	5,637,713.53	17,594,904.97
Transfer to development fund	(33)	5,203,833.80	22,453,954.46
Profit distributable to shareholders		23,939,950,541.11	19,544,440,474.31
Less: Transfer to discretionary earnings reserve	(33)	1,399,787,407.63	1,349,204,962.94
Dividends common stocks	(33)	5,603,840,000.00	5,603,840,000.00
Retained earnings	(33)	16,936,323,133.48	12,591,395,511.37

Note: Refer to Note 11 for additional information about the Income Statement.

The accompanying notes on pages 66 to 134 constitute an integral part of the Financial Statements.

## Consolidated Cash Flow Statement

2006

(Rmb)

	Supple- mentary Data	2006	2005
A. Cash flow from operating activities:			
Cash received from sales of goods and services		184,522,590,487.07	150,388,952,348.78
Refund of taxes		223,138,434.33	120,612,995.88
Cash received in relation to other operating activities		315,909,448.82	163,097,730.87
Sub-total of cash inflows		185,061,638,370.22	150,672,663,075.53
Cash paid for goods and services		140,497,880,626.22	104,426,075,970.62
Cash paid to and on behalf of employees		5,260,554,227.32	4,672,764,738.75
Taxes paid		11,922,527,234.08	14,891,878,690.98
Cash paid in relation to other employees		5,784,593,027.59	3,960,086,765.78
Sub-Total of Cash outflow		163,465,555,115.21	127,950,806,166.13
Net cash flow from operating activities	I	21,596,083,255.01	22,721,856,909.40
B. Cash flow from investing activities			
Cash received from recovery-of-investment		2,308,114,616.05	1,245,828,541.84
Cash received from investment gains		493,264,448.11	102,869,178.45
Net proceeds from the disposal of fixed assets, intangible assets and other long-term assets		375,315,936.98	65,205,321.57
Net increase of cash and cash equivalents from acquisitions of subsidiaries	4	3,109,678.67	39,452,986.04
Net increase of cash and cash equivalents from transformation of subsidiaries into affiliated companies	5	10,834,071.89	-
Net increase of cash and cash equivalents from transformation of affiliated companies into subsidiaries	6	-	19,048,323.88
Cash received in relation to other operating activities		91,173,080.67	55,875,874.69
Sub-total of cash inflow		3,281,811,832.37	1,528,280,226.47
Cash paid for acquisition of fixed assets, intangible assets and other long-term assets		17,903,759,934.78	9,833,579,702.79
Cash paid for investment		2,541,484,810.62	1,068,085,055.15
Decrease in cash and cash equivalents from sales of subsidiaries	7	56,127,033.21	-
Decrease in cash and cash equivalents from acquired companies	8	-	9,314,087,814.98
Decrease in cash and cash equivalents from acquired assets	9	-	16,026,161,168.18
Sub-total of cash outflow		20,501,371,778.61	36,241,913,741.10
Net cash flow from investing activities		(17,219,559,946.24)	(34,713,633,514.63)
C. Cash inflow from financing activities			
Net cash flow from new share issuance		-	25,410,718,814.51
Cash received from minority shareholders' equity investment		114,731,460.38	6,942,478.31
Cash received from loans		76,957,588,706.91	50,829,059,796.26
Sub-total of cash inflows		77,072,320,167.29	76,246,721,089.08
Repayment of loans		70,596,044,295.62	51,450,838,223.33
Cash paid for dividends or interest payment		7,068,847,047.95	7,394,675,206.76
Cash paid to minority shareholders for dividends or earnings		133,449,465.58	420,676,369.32
Cash paid for assets of Phase-3 and acquisition of parts of assets under custody		3,200,000,000.00	3,200,000,000.00
Sub-total of cash outflow		80,998,340,809.15	62,466,189,799.41
Net cash flow from financing activities		(3,926,020,641.86)	13,780,531,289.67
D. Effect of exchange rate fluctuations on cash flow		29,686,584.24	(4,441,206.64)
E. Net increase in cash and cash equivalents		480,189,251.15	1,784,313,477.80

The accompanying notes on pages 66 to 134 constitute an integral part of the Financial Statements.

## Consolidated Cash Flow Statement (Continued)

2006

(Rmb)

Supplementary Data	2006	2005
(1) Reconciliation of net profit to cash flow from operations		
Net profit	13,010,264,517.47	12,665,528,991.45
Add: Provision for impairment losses of assets	(605,201,297.75)	442,228,718.56
Depreciation of fixed assets	12,299,082,999.91	10,615,802,853.14
Amortization of intangible and other assets	41,342,539.04	57,249,017.01
Amortization of long-term deferred expenses	112,373,532.19	58,340,920.92
Losses of deferred expenses (less: increase)	1,691,837.16	103,928,166.01
Increase in accrued expenses (less: decrease)	(52,348,276.06)	(181,687,178.39)
Losses on disposal of fixed assets, intangible assets and other long-term assets (less: gains)	73,115,082.45	243,906,480.56
Financial expenses	1,250,516,304.15	1,006,707,090.67
Losses of investment income (less: gains)	(325,367,320.37)	(184,152,693.92)
Losses/gains of minority shareholders	452,192,302.03	(131,322,362.18)
Deferred tax debits (less: loans)	(119,683,767.99)	(125,887,503.65)
Decrease in inventories (less: increase)	(5,819,593,266.74)	5,138,876,332.57
Decrease in operating receivables (less: increase)	2,247,195,410.76	13,485,802,419.09
Increase in operating receivables (less: decrease)	(969,497,341.24)	(20,473,464,342.44)
Net cash flow from operating activities	21,596,083,255.01	22,721,856,909.40
(2) Non-cash transactions of investing and financing activities		
Conversion of debt-to-share capital	6,533,884.54	3,525,465.48
(3) Increase in cash and cash equivalents		
Cash at the end of the year	5,337,491,762.14	4,857,302,510.99
Less: Cash at the beginning of the year	4,857,302,510.99	1,581,342,234.69
Add: Cash equivalents at the end of the year	-	-
Less: Cash equivalents at the beginning of the year	-	1,491,646,798.50
Net increase in cash and cash equivalents	480,189,251.15	1,784,313,477.80

The accompanying notes on pages 66 to 134 constitute an integral part of the Financial Statements.

## Consolidated Cash Flow Statement (Continued)

2006

(Rmb)

Supplementary Data (Continued)	2006	2005
(4) Cash flow from target company acquisitions		
Net assets of target Companies		
Cash and cash equivalents	11,279,678.67	65,036,698.74
Inventories	-	143,010,783.33
Long-term investment on stocks	-	16,312,500.00
Fixed assets	557,023.43	186,162,030.73
Construction-in-progress	-	15,000,084.67
Intangible assets	-	4,672,561.69
Long-term deferred expenses	-	1,440,507.59
Other long-term assets	-	4,766,618.46
Deferred taxes	-	608,110.51
Short-term loans	-	(27,000,000.00)
Dividends payable	-	(197,069.72)
Accrued expenses	-	(253,967.95)
Long-term loans	-	(14,000,000.00)
Long-term payables	-	(8,093,070.00)
Operating receivables	1,977,826.75	59,294,756.44
Operating payables	(1,789,397.33)	(161,033,361.64)
Minority shareholder' equity	(1,993,264.28)	(40,485,922.32)
Net assets	10,031,867.24	245,241,260.53
Stock option investment difference from acquisitions	(1,861,867.24)	12,643,303.76
Incl.: debit balance	-	12,886,165.16
credit balance	(1,861,867.24)	(242,861.40)
Consideration	8,170,000.00	257,884,564.29
Type of payment		
Cash	8,170,000.00	25,583,712.70
Equity added to subsidiaries from target company acquisitions	-	17,014,430.58
Equity added to subsidiaries from target asset acquisitions	-	215,286,421.01
	8,170,000.00	257,884,564.29
Analysis of net increase of cash and cash equivalents from acquisitions of subsidiaries		
Cash payout	(8,170,000.00)	(25,583,712.70)
Interest from payment date to delivery date	11,279,678.67	65,036,698.74
Net cash inflow	3,109,678.67	39,452,986.04

Note: Refer to Note 4 (i) 14 for additional information about the acquired subsidiaries.

The accompanying notes on pages 66 to 134 constitute an integral part of the Financial Statements.

## Consolidated Cash Flow Statement (Continued)

2006

(Rmb)

Supplementary Data (Continued)		2006
(5)	Cash flow from subsidiaries' transfer to affiliated company	
	Net assets on transferring day	
	Cash and cash equivalents	2,448,800.11
	Inventories	700.00
	Fixed assets	1,127,834.85
	Operating receivables	1,940,300.72
	Operating payables	(1,366.00)
	Minority shareholders' equity	(1,155,612.18)
	Net assets	4,360,657.50
	Equity of affiliated company after transfer	(2,454,672.26)
	Income from equity transfer	11,376,886.76
	Consideration	13,282,872.00
	Payment	
	Cash	13,282,872.00
	Analysis of net increase from subsidiary' transfer to affiliated company	
	Cash income	13,282,872.00
	Cash and cash equivalents on transferring day	(2,448,800.11)
	Net cash inflow	10,834,071.89

Note: Refer to section 2 of Note 4(2) for additional information about the transfer.

## Consolidated Cash Flow Statement (Continued)

2006

(Rmb)

Supplementary Data (Continued)		2005
(6)	Cash flow from accounting due to affiliated company's transfer to subsidiary	
	Net capital on transferring day	
	Cash and cash equivalents	20,210,484.75
	Inventories	140,422.11
	Deferred expenses	334,114.00
	Fixed assets	6,915,477.56
	Intangible assets	2,603,022.10
	Long-term deferred assets	322,673.79
	Other long-term assets	97,560.00
	Deferred taxes	4,800.37
	Operating receivables	59,364,665.29
	Operating payables	(13,759,499.97)
	Minority shareholders' equity	(13,773,162.17)
	Net assets	62,460,557.83
	Equity investment difference	2,514,282.07
	Incl.: debit balance	2,727,155.62
	Credit balance	(212,873.55)
	Consideration	64,974,839.90
	Payment	
	Cash	1,162,160.87
	Original affiliated company's equity	19,120,022.13
	Equity added to affiliated company from target companies acquisitions	39,632,149.50
	Equity added to affiliated company from target assets acquisitions	5,060,507.40
		64,974,839.90
	Analysis of net increases in cash and cash equivalents from transfer accounting	
	Cash payout	(1,162,160.87)
	Cash and cash equivalents on transferring day	20,210,484.75
	Net cash inflow	19,048,323.88

The accompanying notes on pages 66 to 134 constitute an integral part of the Financial Statements.

## Consolidated Cash Flow Statement (Continued)

2006

(Rmb)

Supplementary Data (Continued)		2006
(7)	Cash flows from disposal of subsidiaries	
	Net assets on settling day	
	Cash and cash equivalents	206,524,719.06
	Fixed assets	183,194,579.17
	Long-term deferred expenses	5,609,094.95
	Long-term debt investment	261,333,413.17
	Deferred tax debits	35,916.41
	Other long-term assets	445,711,168.49
	Accrued expenses	(119,716.86)
	Dividends payable	(11,934,104.49)
	Long-term payables	(834,948,673.89)
	Deferred tax credits	(7,258,421.57)
	Operating receivables	63,001,726.23
	Operating payables	(74,482,338.02)
	Net assets value	236,667,362.65
	Equity investment difference	(86,269,676.80)
	Consideration	150,397,685.85
	Payment	
	Cash	150,397,685.85
	Analysis of net decreases in cash and cash equivalents from disposal of subsidiaries	
	Cash income	150,397,685.85
	Cash and cash equivalents on settling day	(206,524,719.06)
	Net cash inflow	(56,127,033.21)

Please refer to Note 14(ii)2 for details about cash flow from disposal of subsidiaries.

The accompanying notes on pages 66 to 134 constitute an integral part of the Financial Statements.

## Consolidated Cash Flow Statement (Continued)

2006

(Rmb)

Supplementary Data (Continued)		2005
(8)	Cash flow from acquisitions of target companies	
	Acquired net assets	
	Cash and cash equivalents	8,609,493,354.51
	Short-term investment	70,289,483.63
	Dividends receivables	1,651,406.00
	Inventories	17,870,854,201.91
	Deferred expenses	65,522,405.38
	One-year due long-term debt investment	6,000,000.00
	Long-term equity investment	1,559,289,121.75
	Fixed assets	12,798,179,392.24
	Project materials	9,039,324.55
	Construction-in-progress	3,296,903,529.14
	Intangible assets	1,260,588,972.26
	Long-term deferred expenses	13,810,509.52
	Other long-term receivables	368,083,389.96
	Other long-term assets	548,556.00
	Deferred taxes	239,917,639.38
	Short-term loans	(9,508,020,107.63)
	Dividends payables	(1,343,164,913.06)
	Accrued expenses	(319,053,803.90)
	One-year due long-term liabilities	(717,437,047.38)
	One-year due long-term payables due to holding company	(32,456,500.00)
	Long-term loans	(2,543,310,008.37)
	Long-term payables	(757,745,105.95)
	Special payables	(18,806,669.94)
	Long-term payables due to holding company	(133,621,442.86)
	Minority shareholders' equity	(4,578,098,403.83)
	Foreign currency translation difference	(229,171.89)
	Operating receivables	20,343,781,762.84
	Operating payables	(29,350,595,407.67)
	Net assets	17,211,414,466.59
	Equity investment difference from acquisition of target companies	713,024,713.71
	Incl.: debit balance	816,133,310.52
	Credit balance	(103,108,596.81)
	Consideration	17,924,439,180.30
	Payment	
	Cash	17,923,581,169.49
	Interest from payment day to delivery day	858,010.81
		17,924,439,180.30
	Analysis of net decreases in cash and cash equivalents from acquisitions of target companies	
	Cash payout	(17,923,581,169.49)
	Cash and cash equivalents from acquisitions	8,609,493,354.51
	Net cash outflow	(9,314,087,814.98)

The accompanying notes on pages 66 to 134 constitute an integral part of the Financial Statements.

## Consolidated Cash Flow Statement (Continued)

2006

(Rmb)

Supplementary Data (Continued)		2005
(9)	Cash flow from acquisitions of target assets	
	Acquired net assets	
	Cash and cash equivalents	75,599,423.38
	Inventories	6,120,333,042.81
	Deferred expenses	46,352,946.72
	Long-term equity investment	352,763,381.41
	Fixed assets	19,299,468,907.22
	Project materials	391,433,767.86
	Construction-in-progress	2,883,485,067.36
	Short-term loans	(6,321,465,883.43)
	One-year due long-term liabilities	(2,856,159,448.24)
	Long-term loans	(2,428,267,921.57)
	Special payables	(22,079,106.34)
	Operating receivables	4,537,979,020.00
	Operating payables	(5,976,899,009.62)
	Net assets value	16,102,544,187.56
	Consideration	16,102,544,187.56
	Payment	
	Cash	16,101,760,591.56
	Interest from payment day to delivery day	783,596.00
	Consideration	16,102,544,187.56
	Analysis of net decreases in cash and cash equivalents from acquisitions of target assets	
	Cash payout	(16,101,760,591.56)
	Cash and cash equivalents from acquisition	75,599,423.38
	Net cash outflow	(16,026,161,168.18)

The accompanying notes on pages 66 to 134 constitute an integral part of the Financial Statements.

## Consolidated Statement of Changes in Shareholders' Equity

2006

	(Rmb)	
	2006	2005
Capital		
Opening balance	17,512,000,000.00	12,512,000,000.00
Increases during the year	-	5,000,000,000.00
Incl.: increased capital from new share issuance	-	5,000,000,000.00
Closing balance	17,512,000,000.00	17,512,000,000.00
Capital reserves		
Opening balance	32,722,971,425.12	12,122,298,027.05
Increases during the year	177,828,426.10	20,600,673,398.07
incl.: Share premium	-	20,410,718,814.51
Reserve for non-cash assets received as donation	369,068.33	639,683.48
Transfer from appropriation	90,211,993.99	62,633,460.11
Reserve for equity investments	(2,059,268.93)	110,872,577.43
Other capital reserves	89,306,632.71	15,808,862.54
Decreases during the year	(96,859,618.35)	-
incl.: Reserve for equity investments	(96,859,618.35)	-
Closing balance	32,803,940,232.87	32,722,971,425.12
Earnings reserves		
Opening balance	11,697,079,788.16	7,260,333,008.18
Increases during the year	3,061,496,895.36	4,436,746,779.98
Incl.: Transfer from net profit	3,061,496,895.36	4,436,746,779.98
incl.: Statutory earnings reserves	1,650,867,940.40	1,529,679,670.20
Statutory public welfare fund	-	1,517,813,287.41
Reserve fund	5,637,713.53	17,594,904.97
Enterprise development fund	5,203,833.80	22,453,954.46
Discretionary earnings reserves	1,399,787,407.63	1,349,204,962.94
Closing balance	14,758,576,683.52	11,697,079,788.16
Incl.: Statutory earnings reserves	5,820,413,691.59	4,169,545,751.19
Statutory public welfare fund	-	4,157,679,368.40
Reserve fund	25,196,736.58	19,559,023.05
Enterprise development fund	29,047,493.55	23,843,659.75
Discretionary earnings reservse	8,883,918,761.80	3,326,451,985.77
Retained earnings		
Opening balance of retained earnings	12,591,395,511.37	9,966,453,299.90
Net profit of the year	13,010,264,517.47	12,665,528,991.45
Profit distributed of the year	(8,665,336,895.36)	(10,040,586,779.98)
Ending balance of retained earnings	16,936,323,133.48	12,591,395,511.37
Foreign currency translation difference		
Opening balance	(48,196,906.49)	-
Changes during the year	(2,097,218.27)	(48,196,906.49)
Closing balance	(50,294,124.76)	(48,196,906.49)

The accompanying notes on pages 66 to 134 constitute an integral part of the Financial Statements.

## Balance Sheet

December 31, 2006

(Rmb)

Assets	Note 5	December 31, 2006	December 31, 2005
Current Assets			
Cash and cash equivalents	(1)	1,855,539,400.90	2,189,074,954.79
Notes receivable	(3)	15,169,065,163.92	10,188,891,250.67
Dividends receivable	(4)	162,605,861.49	-
Trade receivables	(5)	4,201,585,859.73	3,713,354,651.92
Other receivables	(6)	104,483,092.89	258,189,551.75
Payment in advance	(7)	861,737,651.48	1,314,893,573.61
Inventories	(8)	17,988,895,130.31	14,077,262,191.06
Other current assets	(27)	184,886,182.38	-
Total current assets		40,528,798,343.10	31,741,666,173.80
Long-term Investment			
Long-term equity investment	(10)	19,479,558,901.82	17,813,185,412.85
Total long-term investment		19,479,558,901.82	17,813,185,412.85
Fixed Assets	(11)		
Gross fixed assets		151,527,635,065.76	144,546,445,565.12
Less: Accumulated depreciation		86,769,173,957.25	79,311,413,173.43
Fixed assets before revaluation		64,758,461,108.51	65,235,032,391.69
Less: Provision for impairment losses of fixed assets		6,465,062.32	4,434,031.76
Net fixed assets		64,751,996,046.19	65,230,598,359.93
Project materials	(12)	505,337,899.37	309,046,333.31
Construction-in-progress	(13)	11,216,709,073.92	5,126,509,250.79
Total fixed assets		76,474,043,019.48	70,666,153,944.03
Other Assets			
Intangible assets	(14)	25,900,052.50	-
Long-term deferred expenses	(15)	266,959,295.67	366,622,087.59
Circulation right due to share reform	(16)	7,949,489.18	-
Other Long-term receivables		117,905,780.14	-
Total of other assets		418,714,617.49	366,622,087.59
Deferred Taxes			
Deferred tax debits	(17)	237,975,799.07	309,606,832.74
Total Assets		137,139,090,680.96	120,897,234,451.01

The accompanying notes on pages 66 to 134 constitute an integral part of the Financial Statements.

**Balance Sheet (Continued)**

December 31, 2006

(Rmb)

Liabilities & Shareholders' Equity	Note 5	December 31, 2006	December 31, 2005
Current Liabilities			
Short-term loans	(18)	17,982,698,959.71	5,582,948,110.81
Notes payable	(19)	597,066,102.80	1,996,287,990.12
Trade payables	(20)	9,627,260,888.38	8,891,607,607.04
Receipts in advance	(21)	6,808,863,032.42	4,073,388,605.60
Accrued payroll		753,546,447.08	518,826,197.50
Staff welfare payable		228,904,895.27	185,719,820.12
Taxes payable	(23)	1,049,067,180.11	145,291,586.23
Fees due to governments	(24)	15,639,044.41	30,154,946.22
Other payables	(25)	609,749,422.69	1,498,438,469.54
Accrued expenses	(26)	315,394,544.09	32,741,022.22
Other current liabilities	(27)	-	804,769,632.43
One-year due long-term liabilities	(28)	171,378,884.77	2,200,805,645.77
Payables due to holding company		125,010,000.00	125,010,000.00
One-year due long-term payables to holding company	(29)	1,400,000,000.00	3,200,000,000.00
Total current liabilities		39,684,579,401.73	29,285,989,633.60
Long-term Liabilities			
Long-term loans	(28)	12,777,883,761.84	13,324,841,990.87
Special payables		29,297,018.46	29,993,170.22
Long-term payables to holding company	(29)	1,600,000,000.00	3,000,000,000.00
Total long-term liabilities		14,407,180,780.30	16,354,835,161.09
Deferred taxes			
Deferred tax credits	(17)	144,037,093.71	194,985,902.06
Total liabilities		54,235,797,275.74	45,835,810,696.75
Shareholders' Equity			
Capital	(30)	17,512,000,000.00	17,512,000,000.00
Capital reserves	(31)	32,835,964,571.42	32,729,101,673.11
Earnings reserves	(32)	13,807,364,486.20	11,139,595,135.66
Incl.: Statutory public welfare fund		-	3,934,071,397.94
Retained earnings	(33)	18,747,964,347.60	13,680,726,945.49
Incl.: Dividends proposed by Board of Directors	(34)	6,129,200,000.00	5,603,840,000.00
Total shareholders' equity		82,903,293,405.22	75,061,423,754.26
Total liabilities & shareholders' equity		137,139,090,680.96	120,897,234,451.01

The accompanying notes on pages 66 to 134 constitute an integral part of the Financial Statements.

## Income Statement and Profit Appropriation Statement

2006

(Rmb)

	Note 5	2006	2005
Revenues from principal business	(35)	117,603,912,247.41	98,545,901,473.91
Less: Cost of sales	(36)	96,240,007,278.87	75,446,042,622.80
Business tax and surcharges	(37)	531,308,352.94	591,494,143.29
Gross profit from principal business		20,832,596,615.60	22,508,364,707.82
Add: Gross profit from other businesses		143,756,256.16	133,148,538.39
Less: Operating expenses		770,707,925.38	548,693,639.65
Administration expenses		3,820,175,981.71	3,887,783,052.94
Financial expenses	(40)	899,566,732.92	754,018,548.48
Operating profits		15,485,902,231.75	17,451,018,005.14
Add: Investment income	(41)	2,784,579,211.42	998,324,469.81
Subsidies income		32,645,340.00	12,433,000.00
Non-operating income		17,179,679.81	14,482,860.56
Less: Non-operating expenses		193,319,797.08	214,105,349.16
Pre-tax profits		18,126,986,665.90	18,262,152,986.35
Less: income tax expenses		4,788,139,913.25	5,214,549,197.16
Net profits		13,338,846,752.65	13,047,603,789.19
Add: Retained earnings at beginning of the year		13,680,726,945.49	10,151,244,293.06
Distributable profits		27,019,573,698.14	23,198,848,082.25
Less: Transfer to statutory earnings reserve	(33)	1,333,884,675.27	1,304,760,378.92
Transfer to statutory public welfare fund	(33)	-	1,304,760,378.92
Profits distributable to shareholders		25,685,689,022.87	20,589,327,324.41
Less: Transfer to discretionary earnings reserve	(33)	1,333,884,675.27	1,304,760,378.92
Dividends common stocks	(33)	5,603,840,000.00	5,603,840,000.00
Retained earnings	(33)	18,747,964,347.60	13,680,726,945.49

Note: Refer to Note 11 for additional information about the Profit Statement.

The accompanying notes on pages 66 to 134 constitute an integral part of the Financial Statements.

## Cash Flow Statement

2006

(Rmb)

	Comple- mentary Data	2006	2005
A. Cash flows from operating activities			
Cash received from sales of goods and services		134,752,069,136.47	111,228,823,133.01
Refund of taxes		29,867,219.43	12,433,000.00
Cash received in relation to other operating activities		160,956,590.59	62,633,460.11
Sub-total of cash inflows		134,942,892,946.49	111,303,889,593.12
Cash paid for goods and services		102,665,786,303.08	75,899,968,490.73
Cash paid to and on behalf of employees		4,008,640,714.26	3,489,341,632.05
Taxes paid		10,119,163,291.19	12,748,228,820.59
Cash paid in relation to other related operating activities		2,457,754,615.47	1,838,322,926.46
Sub-total of cash outflows		119,251,344,924.00	93,975,861,869.83
Net cash flows from operating activities	1	15,691,548,022.49	17,328,027,723.29
B. Cash flows from investing activities			
Cash received from recovery –of investment		210,658,892.11	1,219,184,994.33
Cash received from investment gains		1,055,889,818.51	345,260,517.86
Net proceeds from the disposal of fixed assets, intangible assets and other long-term assets		85,436,930.56	9,570,144.60
Cash received from acquisition of Baosteel Chemical	4	-	151,259,600.71
Net increases in cash and cash equivalents from acquisition of part of Baosteel International's assets and debts	5	-	235,920,211.34
Cash received in relation to other investing activities		68,347,998.31	52,764,762.52
Sub-total of cash inflows		1,420,333,639.49	2,013,960,231.36
Cash paid for acquisition of fixed assets, intangible assets and other long-term assets		15,572,876,714.72	8,709,805,401.27
Cash paid for investment		278,378,660.14	500,000,000.00
Cash paid for acquisitions of target companies		-	17,923,581,169.49
Cash paid for acquisitions of target assets		-	16,026,161,168.18
Net decrease in cash and cash equivalents from disposal of part of the assets and debts	6	1,274,075.75	-
Cash paid for acquisitions of part of Baosteel Intl's assets and debts		996,589,046.73	-
Cash paid in relation to other investing activities		49,781,127.47	-
Sub-total of cash outflows		16,898,899,624.81	43,159,547,738.94
Net cash flows from investing activities		(15,478,565,985.32)	(41,145,587,507.58)
C. Cash flows from financing activities			
Cash received from equity investment		-	25,410,718,814.51
Proceeds from loans		67,927,044,865.66	36,937,987,700.04
Cash received in relation to other financing activities		107,252,456.01	2,392,511,007.31
Sub-total of cash inflows		68,034,297,321.67	64,741,217,521.86
Repayment of loans		57,880,498,828.68	31,882,595,110.81
Cash paid for dividends, profits and interest payment		6,556,965,589.79	6,508,405,869.54
Cash paid for assets of Phase-3 and acquisitions of parts of assets under custody		3,200,000,000.00	3,200,000,000.00
Cash paid for other related financing activities		989,655,814.81	-
Sub-total of cash outflows		68,627,120,233.28	41,591,000,980.35
Net cash flows from financing activities		(592,822,911.61)	23,150,216,541.51
D. Effect of exchange rate fluctuations on cash flows		46,305,320.55	(33,023,686.20)
E. Net decrease in cash and cash equivalents		(333,535,553.89)	(700,366,928.98)

The accompanying notes on pages 66 to 134 constitute an integral part of the Financial Statements.

## Cash Flow Statement (Continued)

2006

(Rmb)

Supplementary Data	2006	2005
(1) Reconciliation of net profit to cash flows from operations		
Net profit	13,338,846,752.65	13,047,603,789.19
Add: Provision for impairment losses of assets	(412,166,043.73)	564,097,077.80
Depreciation of fixed assets	10,150,281,231.36	9,229,669,848.43
Losses on disposal of fixed assets, intangible assets and other long-term assets (less: gains)	157,637,349.75	200,954,283.91
Amortization of intangible assets	217,647.50	-
Amortization of long-term deferred expenses	99,662,791.92	48,180,239.37
Losses on deferred expenses (less: gains)	-	46,352,946.72
Gains on accrued expenses (less: losses)	-	(4,951,580.13)
Financial expenses	883,910,883.98	746,159,713.07
Losses on investment (less: gains)	(2,784,579,211.42)	(995,746,222.49)
Increase in deferred tax credits (less: debits)	20,682,225.32	(27,223,996.09)
Decrease in inventories (less: increase)	(3,474,187,974.85)	(1,906,868,272.63)
Decrease in operating receivables (less: increase)	(5,148,704,807.19)	(4,692,576,388.54)
Increase in operating payables (less: decrease)	2,859,947,177.20	1,072,376,284.68
Net cash flows from operating activities	15,691,548,022.49	17,328,027,723.29
(2) Non-cash transactions of investing and financing activities		
Conversion of debt to capital reserve	1,004,414.40	465,389.26
(3) Net decrease in cash and cash equivalents		
Cash at the end of the year	1,855,539,400.90	2,189,074,954.79
Less: Cash at the beginning of the year	2,189,074,954.79	1,397,795,085.27
Add: Cash equivalents at the end of the year	-	-
Less: Cash equivalents at the beginning of the year	-	1,491,646,798.50
Net decrease in cash and cash equivalents	(333,535,553.89)	(700,366,928.98)

The accompanying notes on pages 66 to 134 constitute an integral part of the Financial Statements.

## Cash Flow Statement (Continued)

2006

(Rmb)

Supplementary Data (Continued)		2005
(4)	Cash flows from Acquisition of Baosteel Chemical	
	Net assets of acquisition	
	Cash and cash equivalents	151,259,600.71
	Short-term investment	27,432,890.18
	Inventories	122,493,346.43
	Other current assets	1,103,088,305.28
	Long-term equity investment	182,729,672.08
	Project materials	13,498.28
	Construction-in-progress	27,988,370.07
	Fixed assets	1,241,870,352.07
	Deferred taxes debits	3,050,491.51
	Operating receivables	558,762,256.87
	Operating payables	(453,496,724.88)
	Net assets	2,965,192,058.60
	Original equity from Baosteel Chemical	2,965,192,058.60
	Analysis of net increase in cash and cash equivalents from acquisition of Baosteel Chemical	
	Cash payout	-
	Cash and cash equivalents of acquisition	151,259,600.71
	Net cash inflows	151,259,600.71
(5)	Cash flows from acquisition of parts of Baosteel Intl's assets and liabilities	
	Net assets of acquisition	
	Cash and cash equivalents	235,920,211.34
	Inventories	140,933,157.41
	Other current assets	484,653,069.60
	Operating receivables	381,634,138.60
	Operating payables	(246,551,530.22)
	Net assets value	996,589,046.73
	Consideration	996,589,046.73
	Payment	
	Other payables	996,589,046.73
	Analysis of net increase in cash and cash equivalents from acquiring parts of Baosteel Intl's assets and liabilities	
	Cash payout	-
	Cash and cash equivalents of acquisition	235,920,211.34
	Net cash inflows	235,920,211.34

The accompanying notes on pages 66 to 134 constitute an integral part of the Financial Statements.

## Cash Flow Statement (Continued)

2006

(Rmb)

Supplementary Data (Continued)		2006
(6)	Cash flows from sales of assets and liabilities	
	Net assets of acquisition	
	Cash and cash equivalents	1,274,075.75
	Fixed assets	1,189,807.03
	Construction-in-progress	1,547,000.00
	Operating receivables	240,555,869.74
	Operating payables	(289,904,423.44)
	Net assets value	(45,337,670.92)
	Consideration	(45,337,670.92)
	Payment type of consideration	
	Other payables	(45,337,670.92)
	Analysis of net decrease in cash and cash equivalents from sales of assets and liabilities	
	Cash income	-
	Cash and cash equivalents of acquisition	(1,274,075.75)
	Net cash inflows	(1,274,075.75)

The accompanying notes on pages 66 to 134 constitute an integral part of the Financial Statements.

## Statement of Changes in Shareholders' Equity

2006

(Rmb)

	2006	2005
Capital		
Opening balance	17,512,000,000.00	12,512,000,000.00
Increase during the year	-	5,000,000,000.00
Incl.: Increased capital from new share issuance	-	5,000,000,000.00
Closing balance	17,512,000,000.00	17,512,000,000.00
Capital reserves		
Opening balance	32,729,101,673.11	12,188,263,343.23
Increase during the year	120,510,691.31	20,541,346,421.20
Incl.: Share premium	-	20,410,718,814.51
Reserve for non-cash assets received as donation	133,999.87	66,665.00
Transfer from appropriation	88,852,917.19	62,633,460.11
Reserve for equity investments	30,519,359.85	66,954,001.00
Other capital reserves	1,004,414.40	973,480.58
Decrease during the year	(13,647,793.00)	(508,091.32)
Incl.: Reserve for equity investments	(13,647,793.00)	(508,091.32)
Closing balance	32,835,964,571.42	32,729,101,673.11
Earnings reserves		
Opening balance	11,139,595,135.66	7,225,313,998.90
Increase during the year	2,667,769,350.54	3,914,281,136.76
Incl.: Transfer from net profits	2,667,769,350.54	3,914,281,136.76
incl.: Statutory earnings reserves	1,333,884,675.27	1,304,760,378.92
Statutory public welfare fund	-	1,304,760,378.92
Discretionary earnings reserves	1,333,884,675.27	1,304,760,378.92
Closing balance	13,807,364,486.20	11,139,595,135.66
Incl.: Statutory earnings reserves	5,267,956,073.21	3,934,071,397.94
Statutory public welfare fund	-	3,934,071,397.94
Discretionary earnings reserves	8,539,408,412.99	3,271,452,339.78
Retained earnings		
Opening balance of retained earnings	13,680,726,945.49	10,151,244,293.06
Net profit of the year	13,338,846,752.65	13,047,603,789.19
Profit distributed of the year	(8,271,609,350.54)	(9,518,121,136.76)
Ending balance of retained earnings	18,747,964,347.60	13,680,726,945.49

The accompanying notes on pages 66 to 134 constitute an integral part of the Financial Statements.

## Notes to the Financial Statements

31st December, 2006

### I. Company Background

Baoshan Iron & Steel Company Limited (hereinafter referred to as "the Company") was incorporated and registered on 3rd February 2000 in China, with the registration number of 3100001006333, under the law of the People's Republic of China (the "PRC"). The Company was established by Baosteel Group Corporation (formerly known as Shanghai Baosteel Group Corporation hereinafter referred to as "Baosteel Group") as the sole originator; under the official approval document No. [1999] 1266, as issued by the State Economic & Trade Commission of China. The Company issued 1,877,000,000 common shares (A shares) to the general public with a par value of one Rmb each and an offering price of Rmb 4.18, by means of on-line stock exchange listing coupled with off-line rationed subscription, from 6th to 24th November 2000, in compliance with the approval document No. [2000] 140, issued by the China Securities Regulatory Commission (the "CSRC").

Following the approval by the CSRC, as provided in the approval document No. [2005] 15, during the 21st to 26th of April 2005, the Company issued five billion shares with a par value of Rmb 1 each and an offering price of Rmb 5.12 per share, including three billion state-owned shares to Baosteel Group and two billion to the general public, with the latter on a combinatory basis of preferential claiming, pro-rata and online and off-line bidding inquiry.

The principal activities of the Company consist of iron and steel production and its related processing, power generation, coal, industrial-gas generation, port terminals, warehouse storage and transportation. It is also engaged in technology development and transfer, technology services and consulting, automobile maintenance, exports of steel products and technology, imports of related materials, machinery, equipment, parts and components, as well as technology (except for restricted items i.e. where imports and exports are prohibited by the Government). The Company also engages in import processing as well as a subsidized trading business.

## II. Principal Accounting Policies, Accounting Estimates, Methods of Preparing Consolidated Financial Statements

The information contained in the Financial Statement was prepared according to the following principal accounting policies, accounting estimates and methods of preparing the consolidated financial statements, which conform to the *Accounting Standards and Regulations for Business Enterprises* and other related supplementary rules that have been issued by the Ministry of Finance of China.

### (1) Accounting system

The Company, its subsidiaries and affiliated enterprises ("the Group") prepare its accounts in compliance with the *Accounting Standards and Regulations for Business Enterprises*. Their overseas subsidiaries, however, adopt the local accounting standards and regulations. When drawing up consolidated accounting statements, such overseas subsidiaries have made appropriate and necessary adjustment according to the *Accounting Standards and Regulations for Business Enterprises*.

### (2) Accounting period

The accounting year of the Group is from 1st January to 31st December of each calendar year.

### (3) Reporting currency

The reporting currency of the Financial Statement is Renminbi (Rmb), and the unit is Rmb yuan, except as indicated.

### (4) Accounting basis and pricing principles

The financial statements of the Company have been prepared on an accrual basis, with the historical cost method as the pricing principle.

### (5) Translation of foreign currencies

Foreign currency transactions are translated into Rmb at the exchange rate quoted by the People's Bank of China (the "PBoC") on the first day of the month of the transactions.

The balance at the end of the year on foreign currency accounts are translated into Rmb at the exchange rates as quoted by the PBoC at the time. The translation difference is included, as exchange gains or losses, in the gains and losses for the period. Exchange gains and losses arising from preparations are included in long-term deferred expenses and those arising from loans used to finance the purchase or construction of fixed assets before they are ready for their intended use are capitalized as part of the costs of the fixed assets.

### (6) Foreign currency statement translation method

All the assets and liabilities are translated into Rmb according to the exchange rate at the end of the year. The items of shareholders' equity except "retained earnings" are translated into Rmb at the exchange rate at the time when the businesses were conducted. The "retained earnings" presented the translated figures and the amount in the "profit and profit appropriation statement". The differences in translated total assets as well as the total liabilities and shareholders' equity are listed separately in "retained earnings" as "foreign currency translation difference". The items in the "profit and profit appropriation statement" are translated into Rmb at the closing exchange rate of the year; so are all the items in the "cash flow statement". All the opening figures and the previous year's actual amount comply with the translated ones of the previous year.

### (7) Cash equivalents

Cash equivalents are short-term, highly liquid investments by the Group, which are readily convertible into known amounts of cash and where there is no significant risk of a change in value.

### (8) Short-term investments

Short-term investments are readily convertible into known amounts of cash with a holding period of no longer than one year. These include equity stock investments, debentures, bonds, unit trusts and funds. They are valued at historical cost but are net of accrued cash dividends and interest.

Cash dividends and interest-received are debited as accrued dividends or interest and are credited under the category of recovery-of-investment. The cost of short-term investment-at-book is written down accordingly. For the disposal of short-term investments, investment gains or losses are realized at the difference between the cost-at-book and the actual sales proceeds. The valuation of short-term investments is made on an individual basis.

Short-term investments are carried at lower of cost or market at the balance sheet date. Loss-provisions for short-term investments are booked if the market price is lower than the investment cost.

## Notes to the Financial Statements (Continued)

31st December, 2006

### II. Principal Accounting Policies, Accounting Estimates, Methods of Preparing Consolidated Financial Statements (Continued)

#### (9) Bad debt provision

(i) Definition of bad debt

- Debtors are declared bankrupt or died and the Company cannot fully recover debt with liquidated assets or estates;
- Debtors default and there is clear evidence that the delinquent liabilities are unrecoverable.

Provisions of identified bad debts are booked before official approval. They are written off against respective trade receivables and other receivables when approved.

(ii) The Group makes special, and general, bad debt provisions on receivables with reference to the individual identification method and the aging analysis. Special bad debt provisions are determined by the management's estimate as to the collectibility of an individual receivable. General bad debt provision is determined by the age of the receivable and the remaining balance after making special provisions at the balance sheet date. The provisioning percentages are as follows:

Age	Percentage of bad debt provision
Less than one year	5%
One to two years	30%
Two to three years	60%
Over three years	100%

#### (10) Inventories

Inventories include raw materials, work-in-progress, finished products and spare parts and consumables. These are products or goods held for sale in the ordinary course of business, in the process of production for sale, or in the form of materials or supplies to be consumed in production or in rendering services.

Inventories are valued at actual cost in accounting. Raw materials are calculated at the purchase prices and the costs comprise the purchasing costs of the materials and other costs incurred in bringing the materials to their present location on a weighted average cost basis. The costs of work in progress and finished products, comprises direct materials, direct labour and an appropriate proportion of production overheads.

The perpetual inventory system was adopted.

Inventory is valued at the lower of the cost or net realizable value; when the selling prices of inventories are lower than the costs, provisions are made at the difference between the cost of an individual inventory item and its net-realizable-value at the balance sheet date. Net realizable value (NRV) is the estimated selling price in the ordinary course of business minus any cost to complete and to sell the goods as well as related taxes necessary to make the sale. Provisions are made on a category by category basis.

**(11) Long-term investments**

Long-term equity investments, including long-term investment in shares and other equity investment, are recorded at its initial cost on acquisition.

While the cost method is used to account for long-term equity investments when the Group does not have control, jointly control or significant influence over the invested enterprise, the equity method is used to account for long-term equity investments when the company can control, jointly control or has significant influence over the invested enterprise.

For long-term equity investments where the equity method is applied, the difference between the initial costs and the share of the investee's net equity is stated as the equity investment difference, and it is amortized throughout the investment period of the contract. When there is no definite investment period, a difference on the debit side, is amortized for no longer than 10 years. When the difference is on the credit side, the amortization period will not be shorter than 10 years. When the initial investment costs are lower than the investee's share of net equity, the difference is recognized and included in the capital reserves.

When the equity method is adopted, the Group adjusted the carrying amount of the investment according to its attributable share of the invested enterprise's net profit and loss and recognized as investment income for the current period accordingly. The net losses incurred by the invested enterprise was reduced to the extent that the carrying amount of the investment was zero.

When the equity method is adopted, the profits or cash dividends declared to be distributed by the invested enterprise were recognized as investment income in the period, with the amount in excess of the above treated as a recovery of investment cost.

Long-term debt investments are initially recorded at actual cost. The interest income is recognized periodically based on the face value and the stated interest rate of the debentures. Premiums and discounts on the debentures are amortized when recognizing interest income through the maturity.

Long-term investments are booked at the lower of the carrying amount or the recoverable amount at the balance sheet date. A provision for loss is made when the recoverable amount is lower than the carrying amount. Premium or discount on investment in bonds was calculated by means of the straightline method and the interest revenue from the investment in bonds was recognized as investment income for the period.

**12. Fixed assets**

Fixed assets refer to the tangible assets held for commodity production, labor service, lease, operation or management and with a useful life of over one year and relatively high unit value.

Fixed assets were recorded in book with the actual cost at the time of the acquisition, and the value of fixed assets comprises purchase cost, value-added tax, import tariffs and other related taxes, and any directly contributable cost of bring the assets to their working condition and location for their intended use, such as payment for shipment and installment. Expenditure incurred after fixed assets have been put into operation, when it can clearly demonstrated that the expenditure has resulted in an increase in future economic benefits expected to be obtained from the use of the fixed assets, is capitalized as an additional cost.

Depreciation is calculated on a straight-line basis to write off the cost of each asset over its useful life after taking into account its residual value. The respective estimated useful lives, salvage value percent and depreciation rates for assets are as follows:

	Useful life (years)	Salvage value	Depreciation rate
Buildings and plants	15 - 35	4%	2.7% - 6.4%
Machinery and equipment	7 - 15	4%	6.4% - 13.7%
Transport vehicles	5 - 10	4%	9.6% - 19.2%
Office and other equipment	4 - 9	4%	10.7% - 24.0%
Expenditure on improvement	5 - 10	-	10.0% - 20.0%

At the end of the period, fixed assets are valued at the lower of the cost and the net realizable value; A fixed-asset-impairment provision is made for fixed assets where the recoverable amount is lower than the book value. It is recognized in the income statement of the current period. The recoverable amount is taken as being the greater of the net selling price and the value-in-use. In assessing the value-in-use, the estimated future cash flows generated by these assets are discounted to their present value.

## Notes to the Financial Statements (Continued)

31st December, 2006

### II. Principal Accounting Policies, Accounting Estimates, Methods of Preparing Consolidated Financial Statements (Continued)

#### 13. Construction-in-progress

Construction-in-progress represents any cost to bring capitalized assets under construction or installation to its intended state. Construction-in-progress is carried at cost and includes all direct materials, direct labor, equipment to be installed, construction and installation costs, construction management fees, trial-run expenses and capitalized borrowing costs.

Construction-in-progress is transferred to fixed assets when the asset is ready for its intended use.

An impairment provision is booked and included in the gains and losses of the period, as appropriate, if the project is suspended and construction is not expected to resume in the following three years, or if the economic reward of the project is uncertain due to a loss of technological competitiveness.

#### 14. Borrowing costs

Borrowing costs comprise the interest, amortization of premiums and discounts, auxiliary charges and foreign exchange translation differences arising from borrowings of the Company.

Specific borrowing costs attributable to the purchase or construction of fixed assets are capitalized if the following three criteria are met:

Expenditure for the fixed assets has been incurred;

Borrowing costs have been incurred;

Purchase or construction activities have begun in order to make the assets ready for their intended use.

If the purchase or construction activities of the assets are suspended for other than normal reasons and for three consecutive months, borrowing costs are expensed up until the point when construction activities resume.

Borrowing costs cease to be capitalized when the assets are ready for their intended use. The subsequent borrowing costs are expensed in the income statement in the period in which they are incurred.

As at the date of publication of the balance sheet, capitalized interest expenses, including amortized premiums or discounts, are subject to the weighted-average amount of the accumulated expenditures for fixed assets purchased, or in-construction, during the period. The weighted average of the interest rates applying to related borrowing has been capitalized within the limit of the total of interest actually paid and of amortized premiums or discounts within the period. Foreign currency translation differences relating to specific foreign currency borrowing and auxiliary charges are capitalized for the amounts actually incurred.

Except for the above borrowing costs, other borrowing costs are expensed in the income statement in the period in which they are incurred.

#### 15. Intangible assets

Intangible assets of the Company are initially stated at the actual cost.

The cost of an intangible asset is evenly amortized starting from its acquisition month over the shortest of the three periods of the estimated useful life, the beneficial period stipulated by the contracts and the effective period stipulated by laws. Intangible assets are amortized evenly over the following periods:

Category	Amortization period
Land use rights	46 - 50
Technical know-how fees	10
Software copyrights	5
Software royalties	5

The intangible assets were booked at the lower of the carrying amount and the recoverable amount at the balance sheet date. A provision for loss is made when the recoverable amount is lower than the provision of impairment of carrying amount and included in the gains and losses in the period.

#### 16. Long-term deferred expenses

Long-term deferred expenses are expenditures already paid by the Group but with an amortization period over one year. Long-term deferred expenses are amortized on a straight-line basis over the beneficiary period.

## 17. Revenue recognition

Revenue is recognized only when the economic benefits flow into the Group and when the revenue and costs in relation to the sales can be measured reliably, on the following basis:

Sales of goods	The Group has transferred significant risks and rewards of the ownership of the goods to the buyer and no longer controls or manages the goods or guarantees an economic reward from the transaction.
Sales of services	Revenue from sales of service is recognized when the service is completed, where the service is carried out and completed in the same accounting period. The percentage of completion method is adopted for services carried out and completed in different accounting periods, as long as the economic benefits can be reliably measured at the balance sheet date. Where the economic benefits cannot be measured in a reliable manner, the income is calculated by the amount of costs already incurred for the transaction and the estimated recoverable amount.
Interest income	Interest income is accrued on a time basis by reference to the principal amount outstanding and the applicable interest rate.
Leasing income	Leasing income is accrued and recognized by the straightline method according to related contracts or agreements.
Income from transfer of asset use rights	Income from transfer of asset use rights is accrued and recognized according to related contracts or agreements as long as the economic benefits of the transaction flow into the Company and the income can be calculated in a reliable manner.

## 18. Income tax

Income tax is provided, using the tax effect accounting method. The liability method is adopted for all temporary differences arising between the tax bases of assets and liabilities and their carrying values for financial reporting. The amount at the end of the year is calculated by the temporary differences at the tax rates that are expected to apply to the year.

## 19. Derivative instruments

Derivative instruments include foreign-exchange forward contracts and swaps, and interest-rate swaps.

At the balance sheet date, derivative contracts have been revalued by using the current market exchange rates for estimating cash inflows and outflows, so as to decide upon the carrying amount and net value of liability of the derivative instruments. Realized or unrealized gains or losses are stated in the income statement of the period as foreign currency translation gains or losses.

When a derivative instrument has been sold or terminated, the transaction gains or losses for the period are sold or terminated by the net-value on-book and liability for the derivative instrument.

## 20. Related party

Two or more parties are related parties when at any time during the financial period one party has direct or indirect control of the other party in financing and decision making, or the parties are subject to common control from the same source.

## 21. Preparation of the consolidated financial statements

The consolidated financial statements have been prepared in compliance with the *Interim Rules for Consolidated Financial Statements* (Finance [1995] No.11) and relevant rules set out issued by the Ministry of Finance of China in regard to the scope of consolidation.

The consolidated financial statements contain financial information of the Company and its subsidiaries, in which the Company holds more than half of the issued shares of capital, or over which it can exert significant controlling powers to govern financial and operating policies. For joint enterprises in which the Group has joint control with other investors, the Group consolidates their accounts using the proportionate consolidation method and according to the percentage of its equity holding in those entities. A joint enterprise is one whose management is jointly controlled by two or more parties according to the contract they signed.

The subsidiaries adopt the same annual report format and accounting policies as the Group when preparing the consolidated financial reports. Intra-group transactions and outstanding balances, and any unrealized gains or losses arising from intra-group transactions, are eliminated in preparing the consolidated financial statements.

Several subsidiaries were excluded in the consolidation in the period reported due to their small sizes, according to the *Official Reply to the Question Regarding to the Scope of Consolidated Financial Statements* by the Ministry of Finance China. Refer to Note 4 for the subsidiaries and joint enterprises included.

The information of the subsidiaries was listed at the time when the Group had the material control over them, until the Group lost the right of control.

## Notes to the Financial Statements (Continued)

31st December, 2006

## III. Taxation

The applicable taxes and tax rates to the Group (overseas subsidiaries excluded) are as follows

1. Value added tax (VAT)	Applicable VAT tax rates are 17% and 13%, subject to goods sold. The amount of VAT payable to government is the total VAT received from sales revenues after deduction of VAT paid to vendors in the same period.
2. Business tax	3 - 5% of the sales revenue.
3. City construction and maintenance taxes	1%, 5% or 7% of VAT payable and business tax.
4. Education surcharge	3% or 4% of VAT payable and business tax.
5. Riverway administration charge	Based on applicable rates set by the government.
6. Property tax	Based on applicable rates set by the government.
7. Corporate income tax	33% of taxable income for the Group. Applicable tax rates for the subsidiaries.
8. Individual income tax	The Group withholds personal income tax on the salaries paid to individuals.

The taxations of overseas subsidiaries of the Group were based on the relevant local laws and regulations on taxation.

#### IV. Subsidiaries, Sub-subsidiaries and Jointly Controlled Entities

I. As at December 31, 2006, particulars of the subsidiaries, sub-subsidiaries and jointly controlled entities were as follows:

Name of Invested companies	Registration place and date	Registered capital		Percentage of equity held		Principal business	Notes
		Currency	Amount (Thousand Yuan)	Direct	Indirect		
Subsidiaries							
Yantai Lubao Steel Tube Ltd. (Yantai Lubao)	Yantai June 3, 1992	Rmb	100,000	79.82%	-	Production & sales of steel tubes	
Baosteel Huangshi Coating & Galvanizing Co., Ltd. (Huangshi Coating & Galvanizing)	Huangshi Dec. 11, 1992	USD	8,000	39.37%	-	Production & sales of galvanized steel sheets	1
Shanghai Baosteel International Economic & Trading Co., Ltd (Baosteel International)	Shanghai June 13, 1985	Rmb	2,248,879	100%	-	Steel trading	
Shanghai Meishan Iron & Steel Co., Ltd. (Meishan Steel Ltd.)	Nanjing June 26, 2001	Rmb	6,256,570	74.01%	-	Production & sales of steel products	
Ningbo Baoxin Stainless Steel Co., Ltd. (Ningbo Baoxin)	Ningbo Mar. 25, 1996	Rmb	2,848,380	54%	-	Processing & sales of cold rolled stainless sheets	
Shanghai Baosight Software Co., Ltd (Baosight Software)	Shanghai June 14, 2001	Rmb	262,244	55.50%	-	Software development	
Baosteel America Trading Inc. (Baosteel America)	Texas, USA Apr. 9, 1996	USD	980	100%	-	Steel trading	
Howa Trading Corporation Ltd. (Howa Trading)	Tokyo, Japan Aug. 26, 1993	JPY	876,000	100%	-	Steel trading	
Baosteel Hong Kong Trading Company Ltd. (Hongkong Trading)	Hongkong, China Jan. 10, 1995	HKD	62,410	100%	-	Steel trading	
Baosteel Trading Europe GMBH (Baosteel Europe)	Hamburg, German Sept. 14, 1993	EUR	2,050	100%	-	Steel trading	
Baosteel Singapore PTE Ltd. (Baosteel Singapore)	Singapore Feb. 25, 1997	SGD	1,500	100%	-	Steel trading	
Bao-Trans Enterprises Ltd. (Bao-Trans Enterprises)	Hong Kong, China Jan. 9, 1992	HKD	1,000	100%	-	Steel trading	
Baosteel Trading (Brazil) Co., Ltd. (Baosteel Brazil Trading)	Rio de Janeiro, Brazil Sept. 1995	USD	980	100%	-	Sales of Iron ore	
Suzhou Baohua Carbon Black Co., Ltd. (Suzhou Baohua)	Suzhou July 14, 1998	Rmb	295,000	60%	-	Production & sales of carbon black etc.	
Shanghai Baosteel Special Metals Co., Ltd. (Special Metals)	Shanghai Oct. 19, 2006	Rmb	50,000	100%	-	Sales of steel	2
Shanghai No.5 Steel Gas Co., Ltd. (No. 5 Steel Gas)	Shanghai July 23, 1997	Rmb	127,718	94.5%	5.5%	Gas supply & inspection; installation & maintenance of gas generation equipment	
Shanghai No.5 Steel Pudong Intl.Trading Co., Ltd. (No.5 steel Pudong International Trading)	Shanghai Nov. 21, 1994	Rmb	17,400	90%	-	Sales of steel products	
Dongguan Baote Die Steel Co., Ltd (Dongguan Baote)	Dongguan Dec. 12, 2002	Rmb	30,000	10%	90%	Production & sales of steel products	
Anhui Wanbao Mining Co., Ltd. (Anhui Wanbao)	Chizhou Oct. 16, 1997	Rmb	32,000	8%	45%	Development & sales of non-metal products, supply of mining equipments	
Bsteel Online Co., Ltd (Bsteel Online)	Shanghai Aug. 7, 2000	Rmb	80,000	38%	50%	E-commerce	

## Notes to the Financial Statements (Continued)

31st December, 2006

## IV Subsidiaries, Sub-subsidiaries and Jointly Controlled Entities (Continued)

Name of Invested companies	Registration place and date	Registered capital		Percentage of equity held		Principal business	Notes
		Currency	Amount (Thousand Yuan)	Direct	Indirect		
Sub-subsidiaries							
Yantai Lubao Industry & Trade Co., Ltd. (Lubao Industry & Trade)	Yantai Sept. 5, 1992	Rmb	1,650	-	100%	Sales of steel tubes	3
Baosteel Group Lubao Steel Tube Sales Office (Lubao Sales)	Shanghai Sept. 16, 1994	Rmb	500	-	100%	Sales of steel tubes	3
Shanghai Baosteel Pudong Intl.Trading (Pudong Intl.Trading)	Shanghai Feb. 26, 1993	Rmb	72,400	-	100%	Steel trading	
Guangzhou Baosteel Southern Trading Co., Ltd. (Guangzhou Southern Trading)	Guangzhou Oct. 19, 1995	Rmb	30,000	-	100%	Steel trading	
Guangzhou Baosteel Jingchang Steel Delivery Co.,Ltd (Baosteel Jingchang)	Guangzhou Jan. 7, 1997	USD	5,086	-	51%	Processing & delivery of steel products	
Baosteel Group Guangzhou Free Trade Zone Intl.Trading Co., Ltd. (Guangzhou Intl.Trading)	Guangzhou Nov. 25, 1998	Rmb	30,000	-	100%	Steel trading	
Tianjin Baosteel Northern Trading Co., Ltd. (Tianjin Northern Trading)	Tianjin Mar. 14, 1996	Rmb	30,000	-	100%	Steel trading	
Chengdu Baosteel Western Trading Co., Ltd. (Chengdu Western Trading)	Chengdu Dec. 25, 1996	Rmb	37,000	-	100%	Steel trading	
Shanghai Baosteel Steel Trading (Baosteel Steel Trading)	Shanghai Apr. 11, 1995	Rmb	93,000	-	100%	Steel trading	
Hangzhou Baomit Steel Processing & Delivery Co., Ltd. (Hangzhou Steel Delivery)	Hangzhou Mar. 6, 1998	Rmb	74,280	-	75%	Processing & delivery of steel products	
Shanghai Baosteel Enterprise Co., Ltd. (Baosteel Enterprise)	Shanghai Dec. 28, 1998	Rmb	38,169	-	80%	Recovery, processing & sales of scrap	
Shanghai Xinran Metal Co., Ltd. (Xinran Metal)	Shanghai Aug. 28, 1995	Rmb	24,500	-	100%	Recovery, processing & sales of scrap	
Shanghai Baosteel Zhushang Automobile Trading Co., Ltd. (Baosteel Auto Trading)	Shanghai Oct. 26, 1993	Rmb	160,000	-	100%	Auto trading	4
Shanghai Baosteel Commerce & Trade Co., Ltd. (Baosteel Commerce & Trade)	Shanghai July 18, 1997	Rmb	132,787	-	100%	Steel trading	
Shanghai Baosteel Intl. Cargo Agency Co., Ltd. (Baosteel Cargo Agency)	Shanghai Aug. 4, 1998	Rmb	6,000	-	100%	Cargo transport agency	
Chongqing Baomit Steel Processing & Delivery Co., Ltd. (Chongqing Baomit)	Chongqing Aug. 28, 2001	Rmb	70,000	-	100%	Processing & delivery of steel products	
Shanghai Petrol-China Baoshun Petro-Chemical Co., Ltd. (Petrol-China Baoshun)	Shanghai Aug. 4, 2000	Rmb	5,000	-	60%	Petro-Chemical product trading	
Shenyang Steel Delivery Co., Ltd. (Shenyang Steel Delivery)	Shenyang Apr. 25, 2002	Rmb	50,000	-	100%	Processing & delivery of steel	
Rizhao Baoxin Mining Resources Co., Ltd. (Rizhao Baoxin)	Rizhao Sept. 24, 2002	Rmb	12,650	-	51%	Ore mining & processing	
Shanghai Shenjing Steel Processing (Shanghai Shenjing)	Shanghai Apr. 28, 1993	USD	11,913.30	-	51%	Production & sales of steel products	
Shanghai Xinhua Steel Co., Ltd. (Xinhua steel)	Shanghai Apr. 28, 1993	USD	4,950	-	90%	Disassembly of condemned & used ships	
Shanghai Baosheng Energy Co., Ltd. (Baosheng Energy)	Shanghai Apr. 7, 2003	Rmb	10,000	-	51%	Coal trading	
Qingdao Baohan Transport & Trading Co., Ltd. (Qingdao Baohan)	Qingdao June 23, 2003	Rmb	6,000	-	60%	Cargo transport	

(Rmb)

Name of Invested companies	Registration place and date	Registered capital		Percentage of equity held		Principal business	Notes
		Currency	Amount (Thousand Yuan)	Direct	Indirect		
Changchun Faw Baoyou Steel Processing & Delivery (Changchun Faw Baoyou)	Changchun July 7, 2003	USD	13,614.46	-	53.19%	Processing & delivery of steel products	
Shanghai Baosteel Transport Co., Ltd. (Baosteel Transport)	Shanghai Dec. 11, 1995	Rmb	50,000	-	100%	Cargo transport	
Shanghai Baosteel Steel Resources Co., Ltd. (Baosteel Steel Resources)	Shanghai July 15, 1995	Rmb	36,000	-	100%	Disassembly of condemned & used vehicles	
Shanghai Baomit Steel Processing & Delivery Co., Ltd. (Shanghai Baomit)	Shanghai Mar. 29, 1996	USD	29,500	-	65%	Processing & delivery of steel products	
Qingdao Baomit Steel Processing & Delivery Co., Ltd. (Qingdao Baomit)	Qingdao May 25, 2001	Rmb	70,000	-	100%	Processing & delivery of steel products	
Fuzhou Baomit Steel Processing & Delivery Co., Ltd. (Fuzhou Baomit)	Fuzhou Jan. 19, 2004	Rmb	50,000	-	75%	Processing & delivery of steel products	
Shanghai Baoding Energy Co., Ltd. (Shanghai Baoding)	Shanghai July 5, 2004	Rmb	10,000	-	51%	Sales of coal and steel products	
Shanghai Baosteel Packing Strip Co., Ltd. (Packing Steel Strap)	Shanghai May 21, 1993	Rmb	79,000	-	90%	Production & Sales of packaging materials	
Foshan Baosteel Stainless Steel Processing & Delivery Co., Ltd. (Foshan Delivery)	Foshan Aug. 20, 2004	Rmb	55,000	-	100%	Processing & delivery of steel products	
Anhui Baosteel Steel Processing & Delivery Co., Ltd. (Anhui Delivery)	Hefei Sept. 17, 2004	Rmb	50,000	-	70%	Processing & delivery of steel products	
Shanghai Baotong Transport Industrial Co., Ltd. (Baotong Transport)	Shanghai Dec. 20, 1993	Rmb	5,000	-	80%	Cargo transport	
Shanghai Baoyang Intl. Shipping Agency Co., Ltd. (Baoyang Intl.)	Shanghai Nov. 19, 2001	Rmb	3,000	-	75%	Transport agency	
Guangzhou Renhui Auto Sales & Service Co., Ltd. (Guangzhou Renhui)	Guangzhou Nov. 26, 2003	Rmb	15,000	-	51%	Auto Sales	
Shanghai Volkswagen Wuxi Designated Maintenance & Repair Centre (Wuxi Designated Maintenance & Repair)	Wuxi July 20, 1991	Rmb	3,500	-	51%	Auto maintenance & repair	
Jiangxi Province Used Car Trading Market Co., Ltd. (Jiangxi Used Car)	Nanchang Jan. 17, 2003	Rmb	5,000	-	60%	Auto Sales	
Shanghai Baosteel Used Motor Vehicles Trading Co., Ltd. (Shanghai Used Car)	Shanghai Dec. 22, 2000	Rmb	15,000	-	81%	Auto Sales	
Jiaxing Baoda Toyota Sales & Service Co., Ltd. (Jiaxing Baoda)	Jiaxing Jan. 12, 2004	Rmb	18,000	-	70%	Auto Sales	
Shanghai Baole Auto Sales & Service Co., Ltd. (Shanghai Baole)	Shanghai Apr. 15, 2004	Rmb	12,000	-	100%	Auto Sales	
Shanghai Baoyou Auto Sales & Service Co., Ltd. (Shanghai Baoyou)	Shanghai June 24, 2004	Rmb	18,000	-	100%	Auto Sales	
Wuhan Baosteel Central China Trading Co., Ltd. (Wuhan Central China)	Wuhan Sept. 15, 2004	Rmb	100,000	-	100%	Steel trading and processing & delivery of steel products	
Shanghai Baosteel Baoshan Steel Trading Co., Ltd. (Baoshan Steel Product)	Shanghai Dec. 23, 2004	Rmb	30,000	-	100%	Processing & sales of metal materials	
Guangzhou Huadu Baomit Auto Spare Parts Co., Ltd. (Guangzhou Huajing)	Guangzhou Feb. 18, 2004	Rmb	51,380	-	74.3%	Processing & sales of Auto spare parts	
Zhejiang Shengsi Baojie Intl. Shipping Agency Co., Ltd. (Shengsi Baojie)	Zhoushan Dec. 4, 2001	Rmb	3,000	-	51%	Shipping agency	

## Notes to the Financial Statements (Continued)

31st December, 2006

## IV Subsidiaries, Sub-subsidiaries and Jointly Controlled Entities (Continued)

Name of Invested companies	Registration place and date	Registered capital		Percentage of equity held		Principal business	Notes
		Currency	Amount (Thousand Yuan)	Direct	Indirect		
Chongqing Baosteel Auto Spare Parts Co., Ltd. (Chongqing Baosteel)	Chongqing July 18, 2006	Rmb	100,000	-	100%	Processing & sales of metal materials	5
Shanghai Baosteel Stainless Steel Processing & Delivery Co., Ltd. (Shanghai Stainless)	Shanghai July 24, 2006	Rmb	90,000	-	100%	Processing & sales of metal materials	6
Nanchang Baojiang Steel Processing & Delivery Co., Ltd. (Nanchang Delivery)	Nanchang Nov. 11, 2006	Rmb	74,800	-	51%	Processing & sales of auto spare parts	7
Tianjin Baosteel Steel Processing & Delivery Co., Ltd. (Tianjin Delivery)	Tianjin Nov. 17, 2006	Rmb	84,130	-	100%	Processing & sales of auto spare parts	8
Guangzhou Baomit Steel Processing Co., Ltd. (Guangzhou Delivery)	Guangzhou Nov. 20, 2006	Rmb	60,000	-	75%	Processing & storage of steel and metal materials	9
Nanjing Baosteel Steel Delivery Co., Ltd. (Nanjing Delivery)	Nanjing Nov. 3, 2006	Rmb	83,790	-	100%	Processing of auto spare parts and metal materials	10
Yantai Baomit Steel Processing Co., Ltd. (Yantai Baomit)	Yantai Nov. 24, 2006	Rmb	61,000	-	65%	Processing & storage of steel and auto spare parts	11
Baosteel Group Shanghai Finance Co., Ltd. (Finance Company)	Shanghai Oct. 6, 1992	Rmb	500,000	-	62.1%	Finance & foreign exchange	12
Nanjing Yishiqi Meishan Energy Co., Ltd. (Yishiqi Energy)	Nanjing June 1, 2001	Rmb	102,800	-	96.6%	Production & sales of electricity and steam	
Nanjing Tiemei Transport & Trading Co., Ltd. (Tiemei Transport)	Nanjing July 23, 1996	Rmb	600	-	55%	Sales of metal materials and transport service	
Ningbo Economic & Technical Development Zone Baoxin Industrial Co., Ltd. (Baoxin Industrial)	Ningbo July 17, 1998	Rmb	6,000	-	51%	Timber & rolled paper processing and stainless steel products packing	
Shanghai Baoxi Computer Technology Co., Ltd. (Baoxi Computer)	Shanghai Mar. 19, 1999	USD	600	-	70%	Software development & technical service	
Shanghai Baojing Information Technology Development Co., Ltd. (Baojing Information)	Shanghai May 13, 1998	Rmb	5,000	-	69.8%	Software development & technical service	
Shanghai Baoli Computer Integration & Development Technology Co., Ltd. (Baoli Integration)	Shanghai Mar. 17, 1994	USD	2,170	-	53%	Software development & technical service	
Shanghai Baokang Electronic Control & Development Engineering Co., Ltd. (Baokang Electronic)	Shanghai Jan. 11, 1994	Rmb	20,000	-	75%	Software development & technical service	
Japan Baosight Software Company (Japan Baosight)	Tokyo Japan Jan. 10, 2003	JPY	25,000	-	100%	Software development & technical service	
Shanghai Baoli Automation Engineering Co., Ltd. (Baoli Automation)	Shanghai June 6, 2006	Rmb	15,000	-	51%	Development, manufacturing & sales of automation control system	13
Shanghai Meishan Designing Institute of Civil Engine Co., Ltd. (Meishan Institute)	Shanghai Aug. 28, 2001	Rmb	6,000	-	95%	Metallurgy & construction designing	14
Chizhou Guichi Gangbu Co., Ltd. (Guichi Gangbu)	Chizhou Oct. 5, 1998	Rmb	10,000	-	60%	Port loading-unloading operation, stacking & warehouse	
Baosight Technology (Hongkong) Co., Ltd. (Baosight Technology)	Hongkong China June 5, 2002	HKD	100	-	100%	Regular business	
Baosteel Australia PTY Limited (Bao-Australia PTY)	Perth Australia July 22, 1994	USD	100	-	100%	Steel products trading	
Baosteel Group Italy Steel Trading Co. Ltd. (Italian Steel)	Genoa Italy Oct. 1, 2001	EUR	4,500	-	51%	Steel products trading	

(Rmb)

Name of Invested companies	Registration place and date	Registered capital		Percentage of equity held		Principal business	Notes
		Currency	Amount (Thousand Yuan)	Direct	Indirect		
Jointly controlled entities							
BNA Automotive Steel Sheets Co., Ltd. (BNA)	Shanghai July 30, 2004	Rmb	3,000,000	50%	-	Production & sales of cold rolled steel sheets and hot-dip galvanized sheets	15
Bao-Island Enterprises Ltd. (Bao-Island Enterprises)	Hongkong China Nov. 3, 1992	HKD	3,300	50%	-	Ship chartering and shipping agency	16
Shanghai Kebao Automotive Transmission Co., Ltd. (Kebao Automotive)	Shanghai June 21, 2005	CAD	10,890	-	50%	Production & sales of automotive transmission & hydraulic speed change valve	17
Niagara Machinery Products Co., Ltd. ((Niagara Machinery)	Ontario Canada Jan. 6, 2005	CAD	37,500	-	50%	Production of valves, and sleeves etc.	18

- Note 1. The Company holds 39.37% of the equity of Huangshi Coating and Galvanizing, but controls more than half of the voting power in the Board of Directors. Accordingly, Huangshi Coating and Galvanizing is consolidated.
- Note 2. On October 19, 2006, the Company established the Special Metal, holding 100% of its equity with investment of Rmb 50 million. As a result, the Special Metal is consolidated ever since its establishment.
- Note 3. These are sub-subsidiaries of the Company, and their revenues, net profits and total assets do not bear significantly on the financial and business performance of the Company. As a result, they are not consolidated; instead, the equity accounting method is applied.
- Note 4. In accordance with the approval of document Business [2006] 1783 of the Ministry of Commerce of the People's Republic of China, Shanghai Baosteel Automobile Trading Co., Ltd. increased its registered capital from the original Rmb 50 million to Rmb 160 million, including Rmb 31.6 million from Baosteel International, a subsidiary of the Company, an investment in form of USD equivalent to Rmb 69.438 million (Rmb 62.4 million as registered capital and the rest as capital reserve) from Sumitomo Corporation and an investment in form of USD equivalent to Rmb 17.805 million (Rmb 16 million as registered capital and the rest as capital reserve) from Sumitomo Corporation (China) Ltd. At the same time, the company became a non-Chinese enterprise and renamed Shanghai Baosteel- Sumitomo Automobile Trading Co. Ltd. On 15th December 2006, the business license changed into Joint Venture Shanghai 043064, as granted by the Bureau of Industry and Commerce of Shanghai. The registered capital is Rmb 160 million. The capital received is now 50 million as the added amount is still to be paid. The Company has had 100% of its equity on 31st December 2006.
- Note 5. Baosteel Chongqing was set up on 18th July 2006 by Baosteel International, a subsidiary of the Company, with a registered capital of 100 million and 100% of its equity. Baosteel Chongqing has been consolidated ever since the day of establishment.
- Note 6. Shanghai Stainless Steel was set up on 24th July 2006 by Baosteel International, a subsidiary of the Company, with a registered capital of 90 million and 100% of its equity. Shanghai Stainless Steel has been consolidated ever since the day of establishment.
- Note 7. Nanchang Delivery was jointly set up on 11th November 2006 by Baosteel International, a subsidiary of the Company, and Jiangling Automobile Group, with a registered capital of Rmb 74.8 million. The contributions of Baosteel International and Jiangling Automobile were Rmb 38.148 million and Rmb 36.652 million, or 51% and 49% respectively. Nanchang Delivery has been consolidated ever since the day of establishment.
- Note 8. Tianjin Delivery was set up on 17th November 2006 by Baosteel International, a subsidiary of the Company, with a registered capital of Rmb 84.13 million and 100% of its equity. Tianjin Delivery has been consolidated ever since the day of establishment.
- Note 9. Guangzhou Delivery was jointly set up on 20th November 2006 by Baosteel International, a subsidiary of the Company, and Mitsui & Co. Ltd. (hereafter referred to as "Mitsui"), with a registered capital of Rmb 60 million. The contributions of Baosteel International and Mitsui were Rmb 45 million and Rmb 15 million, or 75% and 25% respectively. Guangzhou Delivery has been consolidated ever since the day of establishment.
- Note 10. Nanjing Delivery was set up on 3rd November 2006 by Baosteel International, a subsidiary of the Company, with a registered capital of 83.79 million and 100% of its equity. Nanjing Delivery has been consolidated ever since the day of establishment.
- Note 11. Yantai Baomit was jointly set up on 24th November 2006 by Baosteel International, a subsidiary of the Company, and Mitsui, with a registered capital of Rmb 61 million. The contributions of the two partners were Rmb 39.65 million and Rmb 21.35 million, or 65% and 35% respectively. Yantai Baomit has been consolidated ever since the day of establishment.
- Note 12. After the acquisition of target companies/assets through the new share issuance completed on 1st May 2005, the Company indirectly holds 27.11%

## Notes to the Financial Statements (Continued)

31st December, 2006

### IV Subsidiaries, Sub-subsidiaries and Jointly Controlled Entities (Continued)

equity of the Finance Company. In June 2005, the registered capital of the Finance Company was deducted by Rmb 640.11 million, from the original Rmb 1.14011 billion to Rmb 500 million, according to the official reply from China Banking Regulatory Commission, the decision of shareholders' meeting of the Finance Company and the edited regulations of the Finance Company. As the financial contribution of the Group to the Finance Company was not reduced, the equity of the Finance Company held by the Group rose to 62.1% and it became a sub-subsidiary of the Group accordingly. The management of the Company had decided that the Finance Company was not consolidated and accounted by the equity method, as its revenues, profits and assets had no significant impacts on the Group.

- Note 13. Baoli Automation was jointly set up on 6th June 2006 by Baosight Software, a subsidiary of the Company, Hitachi, Ltd. (hereafter referred to as "Hitachi, Ltd.") Hitachi (China), Ltd. (hereafter referred to as "Hitachi (China)"), with a registered capital of Rmb 15 million. The contribution of Baosight Software was Rmb 7.65 million, or 51% of the registered capital, and the other two contributed Rmb 5.85 million and Rmb 1.5 million, or 39% and 10% of the registered capital respectively. Baoli Automation has been consolidated ever since the day of establishment.
- Note 14. According to the share transfer contract signed by Baosight Software and Baosteel Group, Baosteel Group transferred the 95% stake of Meishan Designing Institute it held. Since 30th April 2006, Baosight has begun to practice its controlling right over Meishan by sending management and financial personnel. As a result, Meishan has been consolidated since 1st May, 2006 in the Financial Statements of the Company.
- Note 15. BNA Automotive Steel Sheets Co., Ltd. was jointly set up by the Company, Nippon Steel Corporation (Nippon Steel) and Arcelor on July 30, 2004, with a registered capital of Rmb 3bn. With respective contributions of 1.5 bn, Rmb 1.14 bn and Rmb 0.36 bn, the Company owns 50% of the capital, Nippon Steel 38% and Arcelor 12%. At the preparation of consolidated financial statements, the Company consolidated the assets, liabilities, revenues, costs and expenses of BNA Automotive Steel Sheets based on a proportionate method. In accordance with the *China Enterprise Accounting System*, at the preparation of the Company's financial statements, long-term investment in BNA Automotive Steel Sheets has been accounted under the equity method.
- Note 16. Bao-Island Enterprises is a joint venture established by Baosteel Group and Jinshan Shipping Agency Co., Ltd. on Nov. 3, 1992. The registered capital was 3.3 mn HKD, each with 50% stake. It was transformed to an associate of the Group after the acquisition of target companies/assets through the new share issuance on May 1, 2005. At the preparation of consolidated financial statements, the Company consolidated the assets, liabilities, revenues, costs and expenses of Bao-Island Enterprises based on a proportionate method. In accordance with the *China Enterprise Accounting System*, at the preparation of the Company's financial statements, long-term investment in Bao-Island Enterprises has been accounted under the equity method.
- Note 17. Kebao Automotive is a joint venture formed by Baosteel International and St. Catharines Machine Products Inc. (St. Catharines Machine) on June 21, 2005. The registered capital is 10.89 mn Canadian Dollars, with each contributing 5.445 mn – 50% of the capital. Kebao Automotive becomes the associate of the Group. It is not consolidated as the management of the Company thinks that its revenues, profits and assets have no significant impacts. Therefore it is accounted by the equity method.
- Note 18. In accordance with the contract of equity transfer between Baosteel International and St. Catharines Machine on June, 2005, Baosteel International purchased 50% of the equity of Niagara Machine Products held by St. Catharines Machine with a consideration of 18.75 million Canadian dollars. Transaction of the relevant procedures on the transfer of equity has been completed on June, 2005. Niagara Machine Products therefore has become a jointly controlled entity of Baosteel. The management of Baosteel considers that the sales income, net profit, and total asset of Niagara Machine Products constitute no significant impact on the Group's financial and business results and they, according to relevant regulations, can be exempted from the consolidation and be accounted by the equity method.

## 2. Particulars of Subsidiaries Excluded from Baosteel in 2006 are as follows:

Name of Invested companies	Registration place and date	Registered capital		Percentage of equity held		Principal business	Notes
		Currency	Amount (Thousand yuan)	Direct	Indirect		
Baosteel Australia PTY Limited (Bao-Australia PTY)	Perth Australia 10, May, 2002	AUD	19,960	100%	-	Production and sale of iron ore	1
Shanghai Renwei Software Co. Ltd. (Renwei Software)	Shanghai 15, March, 2004	USD	1,500	-	73.33%	Software development technical service	2
Chemical Department of Shanghai Baoshan Iron & Steel Plant (Chemical Sales Office)	Shanghai 19, November, 1992	RMB	300	100%	-	Wholesale and retail of chemical raw materials and products	3

Note 1. In accordance with the Group's method of consolidating the financial statements, subsidiaries are included in the consolidation since the Group acquires material control power over them and the consolidation remains until the control power is transferred out of the Group. Since May 1, 2005 when the Company completed its purchase of the target companies/assets, it has assumed responsibility over the operation and financial management of the target companies and acquired the material control power. Baosteel Australia PTY Limited, which is one of the Company's target companies, has been included into the scope of the consolidated accounting statement of the Group since May 1, 2005. In accordance with the *Official and Written Reply on the Agreement of Baosteel Group Corporation to Continue to Own All the Equity of Baosteel Australia PTY Limited* issued by the Department of Commerce and the *Supplementary to the Agreement on Baosteel Group Corporation's Purchase of the Equity of Its Overseas Companies* signed between Baosteel Co., Ltd and Baosteel Group, the Company discontinues its purchase of the equity of Baosteel Australia PTY Limited held by Baosteel Group and stops to transact the legal procedures of purchasing the equity of Baosteel Australia PTY Limited. Meanwhile, the Company does not assume the responsibility of the operation and financial management of Baosteel Australia PTY Limited in 2006. Instead, Baosteel Group shall be held responsible. The material control power over Baosteel Australia shall be transferred out of the Group. Therefore, Baosteel Australia PTY Limited shall not be included in the scope of the Group's consolidation in 2006.

Note 2. In October 2006, Baosight, a subsidiary of the Company, sold 32% of the equity of its subsidiary — Renwei Software. The equity that the Group has of Renwei Software reduced from 73.33% to 41.33%. Therefore, from October 31, 2006, Renwei Software was accounted as a joint company, instead of a sub-subsidiary.

Note 3. As liquidation was under way for the Chemical Sales Office in 2005 and the relevant legal formalities over its cancellation being transacted, the sales office was not consolidated according to the relevant regulations and therefore the equity method was used in 2005. In 2006, Chemical Sales Office completed its liquidation.

## Notes to the Financial Statements (Continued)

31st December, 2006

## V. Explanatory Notes to Major Accounting Items

## (1) Cash and cash equivalents

	The Group		The Company	
	Dec. 31, 2006	Dec. 31, 2005	Dec. 31, 2006	Dec. 31, 2005
Cash	1,915,475.84	1,546,095.56	20,264.08	115,666.20
Deposit with banks				
Deposit in RMB	1,394,308,467.35	1,396,475,676.18	236,709,697.49	298,869,130.79
Deposit in USD	1,908,079,157.81	1,385,027,643.54	279,106,737.58	225,492,983.04
Deposit in JPY	83,595,299.20	87,669,576.48	474,497.66	23,476,974.81
Deposit in Euro	273,037,618.22	171,091,199.74	1,454,574.77	132,702,645.48
Deposit in AUS Dollar	735,859.93	205,741,312.01	-	-
Deposit in HKD	141,943,962.15	2,256,062.50	-	-
Deposit in other Foreign currencies	7,076,562.17	9,312,176.82	-	-
Deposit of Baosteel Group Finance Co., Ltd,				
Deposit in RMB	1,470,099,037.60	1,312,193,445.23	1,336,597,803.96	1,309,079,124.17
Deposit in USD	-	5,019,231.92	-	5,019,231.92
Deposit in JPY	-	134,662.44	-	134,662.44
Deposit in Euro	-	567,734.41	-	567,734.41
Other cash equivalents	56,700,321.87	280,267,694.16	1,175,825.36	193,616,801.53
Total	5,337,491,762.14	4,857,302,510.99	1,855,539,400.90	2,189,074,954.79

The foreign currency translation rate adopted is: 1 USD for 7.8087 Rmb (Year 2005: 8.0702 Rmb); 1 JPY for 0.0656 RMB (Year 2005: 0.0687 Rmb); 1 EURO for 10.2665 Rmb (Year 2005: 9.5797 Rmb); 1 AUS Dollar for 6.0065 Rmb (Year 2005: 5.9268 Rmb); 1 HKD for 1.00471 Rmb (Year 2005: 1.0403 Rmb).

By December 31, 2006, other cash and cash equivalents of the Group consist of a credit card deposit of Rmb 1,929,139.23 yuan, a bank checking account deposit of Rmb 38,036,425.66, and a bank acceptance bill deposit of Rmb 16,734,756.98.

(Rmb)

## (2) Short-term investment

	The Group		The Company	
	Dec. 31, 2006	Dec. 31, 2005	Dec. 31, 2006	Dec. 31, 2005
Stock investment	3,254,946.41	24,751,520.41	-	-
Fund investment	7,248,445.13	4,028,340.47	-	-
Commission asset management	1,000,000.00	2,500,000.00	-	-
Less: provision for short-term investment	-	4,265,628.09	-	-
	11,503,391.54	27,014,232.79	-	-

Provision for short-term investment analysis is as follows:

	The Group		The Company	
	Year 2006	Year 2005	Year 2006	Year 2005
Opening balance	4,265,628.09	-	-	-
Additions from the acquisition of target companies through new share issuance	-	1,004,840.32	-	-
Additions from the merger of Baosteel Chemical	-	-	-	2,578,247.32
Provision of the year	-	5,839,035.09	-	-
Write-off of the year	(4,265,628.09)	-	-	-
Less of the year	-	(2,578,247.32)	-	(2,578,247.32)
Closing balance	-	4,265,628.09	-	-

By December 31, 2006, the total market price of the Group's stock investment and fund investment is Rmb 13,896,225.54 (Year 2005: Rmb 27,638,172.59). The management of the Group considers that there does not exist major restrictions on the cashing of the Group's short-term investment on December 31, 2006.

## (3) Notes receivables

	The Group		The Company	
	Dec. 31, 2006	Dec. 31, 2005	Dec. 31, 2006	Dec. 31, 2005
Bank acceptances	2,830,616,983.14	2,131,875,157.32	1,103,569,050.51	813,137,561.25
Trade acceptances	2,369,958,955.52	6,357,093,819.09	14,065,496,113.41	9,375,753,689.42
Included: Related company's trade acceptances	1,688,225,565.31	5,589,440,095.18	14,042,355,358.31	9,145,771,498.61
Total	5,200,575,938.66	8,488,968,976.41	15,169,065,163.92	10,188,891,250.67
Included: Discounted pre-expiracy notes-receivable	205,689,925.62	1,328,134,425.14	5,103,802,821.50	-

There are no notes-receivable due from any shareholder holding 5% or more of the Company's shares or voting power.

Under relevant rules set out by the Ministry of Finance in the supplementary document No. [4] covering the implementation of the *Accounting Regulations for Business Enterprises* and related accounting standards, the Group credits short-term loans when discounting notes-receivable with financial institutions.

## Notes to the Financial Statements (Continued)

31st December, 2006

### V. Explanatory Notes to Major Accounting Items (Continued)

#### (4) Dividend receivables

The Group

	Dec. 31, 2006	Dec. 31, 2005
Shanghai CIMC Baowell Industries Co., Ltd.	-	48,733,952.01
Finance Company	-	17,324,529.37
Total	-	66,058,481.38

The Company

	Dec. 31, 2006	Dec. 31, 2005
Baosteel Hong Kong	162,605,861.49	-

(Rmb)

## (5) Trade receivables

	The Group		The Company	
	Dec. 31, 2006	Dec. 31, 2005	Dec. 31, 2006	Dec. 31, 2005
Trade receivables	5,547,133,833.97	5,114,397,672.57	4,515,330,869.58	4,042,077,329.18
Less: Bad debt provision	365,207,663.04	343,970,128.83	313,745,009.85	328,722,677.26
Net amount of trade receivables	5,181,926,170.93	4,770,427,543.74	4,201,585,859.73	3,713,354,651.92

Aging analysis of the trade receivables as follows:

The Group

	Dec. 31, 2006			Dec. 31, 2005		
	Book value	Percentage	Bad debt provision	Book value	Percentage	Bad debt provision
Within 1 year	5,238,426,609.64	94.43%	172,165,969.06	4,875,676,473.05	95.33%	158,804,310.78
1-2 years	121,352,689.69	2.19%	21,357,765.92	71,363,840.25	1.40%	20,532,871.42
2-3 years	39,176,516.46	0.71%	23,505,909.88	7,071,414.08	0.14%	4,347,001.44
Over 3 years	148,178,018.18	2.67%	148,178,018.18	160,285,945.19	3.13%	160,285,945.19
Total	5,547,133,833.97	100%	365,207,663.04	5,114,397,672.57	100%	343,970,128.83

The Company

	Dec. 31, 2006			Dec. 31, 2005		
	Book value	Percentage	Bad debt provision	Book value	Percentage	Bad debt provision
Within 1 year	4,419,795,194.71	97.88%	220,989,759.76	3,891,712,885.28	96.28%	193,893,181.44
1-2 years	3,970,724.64	0.09%	1,191,217.39	22,159,711.92	0.55%	6,647,913.58
2-3 years	2,293.82	0.00%	1,376.29	57,874.35	0.00%	34,724.61
Over 3 years	91,562,656.41	2.03%	91,562,656.41	128,146,857.63	3.17%	128,146,857.63
Total	4,515,330,869.58	100%	313,745,009.85	4,042,077,329.18	100%	328,722,677.26

## Notes to the Financial Statements (Continued)

31st December, 2006

## V. Explanatory Notes to Major Accounting Items (Continued)

The analysis of bad debt provisions for trade receivables at the year-end is as follows:

	The Group		The Company	
	2006	2005	2006	2005
Opening balance	343,970,128.83	216,911,503.46	328,722,677.26	216,547,191.38
Additions from acquisition of target companies through new share issuance	-	154,652,931.69	-	-
Additions from acquisition of target assets through new share issuance	-	29,731,341.61	-	29,731,341.61
Additions from acquisition of subsidiaries	43,817.80	2,328,977.38	-	-
Additions from the accounting of associates as subsidiaries	-	37,861.60	-	-
Additions from the acquisition of partial assets and debts of Baosteel International	-	-	-	57,341,560.94
Additions from the merger of Baosteel Chemical	-	-	-	2,185,008.14
Recovery of previously written-off bad debt	662,706.50	632,621.87	662,706.50	632,621.87
Provision of the year	153,307,641.58	111,241,022.71	92,811,731.69	71,144,150.19
Reversal of the year	(115,188,010.99)	(170,474,785.19)	(61,928,780.89)	(41,775,142.90)
Other transfer	-	-	-	(7,084,053.97)
Bad debt written-off for the year	(17,697,383.79)	-	(8,690,621.49)	-
Decrease due to transfer of partial assets and debts	-	-	(37,832,703.22)	-
Foreign currency translation difference	108,763.11	(1,091,346.30)	-	-
Closing balance	365,207,663.04	343,970,128.83	313,745,009.85	328,722,677.26

The closing balance of trade receivables from the five largest debtors for the Group totaled Rmb 1,064,614,730.41 yuan versus Rmb 643,894,182.43 yuan in 2005, or 19.19% of total trade receivables (2005: 12.59%); and for the Company, the total amount was Rmb 2,441,844,350.10 yuan versus Rmb 1,594,143,163.65 yuan in 2005, or 54.08% of total notes receivables (2005: 39.44%).

On December 31, 2006, the net value of RMB 24,580,783.74 in the trade receivables of the Group was used as a pledge for the short-term loan of Rmb 10,000,000.00.

Under relevant rules set out by the Ministry of Finance in the supplementary document No. [4] covering the implementation of the *Accounting Regulations for Business Enterprises* and related accounting standards, the Group credits short-term loans when obtaining hypothecation loans with account receivable from financial institutions.

(Rmb)

Receivables due from related companies at the year-end are as follows:

	The Group		The Company	
	Dec. 31, 2006	Dec. 31, 2005	Dec. 31, 2006	Dec. 31, 2005
Baosteel Group Corp.	6,143,232.24	12,352,950.69	996,436.02	4,512,020.35
Baosteel International and its subsidiaries	-	-	692,065,633.18	944,108,056.01
Baosteel America Inc	-	-	485,629,236.28	247,850,084.16
Baosteel Trading Europe GmbH	-	-	374,268,466.00	442,842,948.69
Howa Trading Co., Ltd. (Japan)	-	-	591,350,038.57	164,576,578.08
Baosteel Trading Co., Ltd. (Singapore)	-	-	48,401,627.88	121,073,454.24
BNA Auto Steel Sheets Co., Ltd.	339,821,653.05	204,247,471.13	678,304,471.73	408,463,128.38
Ningbo Baoxin	-	-	64,155,589.77	15,361,104.74
Meisteel Co.,	-	-	224,943,368.12	308,570,249.36
Baosteel Group Nantong Steel Manufacturing Co., Ltd.	48,060,351.68	30,053,070.54	48,056,993.17	29,619,912.03
Baosteel Group Shanghai No. 1 Steel Co., Ltd. and its subsidiaries	4,916,266.06	52,133,816.65	4,859,003.55	52,133,816.65
Baosteel Group Shanghai Pudong Steel Co., Ltd and its subsidiaries	153,389,630.39	162,181,401.03	147,233,740.81	108,088,036.28
Shanghai Baosteel Industrial Development Co., Ltd and its subsidiaries	5,138,017.52	17,734,489.06	5,138,017.52	17,734,489.06
Baosteel Group Shanghai No. 5 Steel Co., Ltd. and its subsidiaries	10,647,960.35	17,816,364.72	10,229,137.25	17,796,364.72
Shanghai Steel Research Institute and its subsidiaries	-	13,850,221.12	-	13,850,221.12
Baosteel Group Enterprise Development Corporation and its subsidiaries	38,920,247.92	57,350,876.20	38,448,344.72	56,896,666.18
Baosteel Group Shanghai Meishan Co., Ltd. and its subsidiaries	142,610,358.71	101,062,487.41	-	-
Baosteel Trading Co., Ltd.	128,975,039.15	-	128,975,039.15	-
Fortune Trust & Investment Co., Ltd.	14,660,102.44	1,180,746.13	-	-
Shanghai Baosteel Equipment Maintenance Co., Ltd	11,653,727.07	7,907,846.02	9,211,436.60	-
Other	16,144,164.72	12,059,571.73	18,978,616.05	43,369,697.00
Total	921,080,751.30	689,931,312.43	3,571,245,196.37	2,996,846,827.05

Except for receivables due from the holding company, Baosteel Group Corp. (see above table), no balance is due from a shareholder who holds 5% or more of the Company's shares or voting power at the year end. All receivables due from related companies are due within one year, with no pledges, non-interest-bearing and are fully recovered when called.

## Notes to the Financial Statements (Continued)

31st December, 2006

## V. Explanatory Notes to Major Accounting Items (Continued)

## (6) Other receivables

	The Group		The Company	
	Dec. 31, 2006	Dec. 31, 2005	Dec. 31, 2006	Dec. 31, 2005
Other receivables	1,003,685,750.66	612,581,939.04	109,170,274.97	271,386,994.39
Less: bad debt provision	151,711,449.65	137,428,337.69	4,687,182.08	13,197,442.64
Other receivables (net)	851,974,301.01	475,153,601.35	104,483,092.89	258,189,551.75

Aging analysis of other receivables is as follows:

## The Group

	Dec. 31, 2006			Dec. 31, 2005		
	Book value	Percentage	Bad debt provision	Book value	Percentage	Bad debt provision
Within 1 year	834,811,437.97	83.17%	17,704,115.47	426,997,635.43	69.70%	9,704,715.19
1-2 years	9,228,272.28	0.92%	1,478,481.68	28,767,919.56	4.70%	6,549,986.25
2-3 years	16,124,651.19	1.61%	13,238,034.03	26,573,956.84	4.34%	3,944,374.10
Over 3 years	143,521,389.22	14.30%	119,290,818.47	130,242,427.21	21.26%	117,229,262.15
Total	1,003,685,750.66	100%	151,711,449.65	612,581,939.04	100%	137,428,337.69

## The Company

	Dec. 31, 2006			Dec. 31, 2005		
	Book value	Percentage	Bad debt provision	Book value	Percentage	Bad debt provision
Within 1 year	108,864,552.92	99.72%	4,594,765.46	249,861,772.18	92.07%	12,109,805.74
1-2 years	304,722.05	0.28%	91,416.62	625,121.88	0.23%	187,536.57
2-3 years	-	0.00%	-	20,000,000.00	7.37%	-
Over 3 years	1,000.00	0.00%	1,000.00	900,100.33	0.33%	900,100.33
Total	109,170,274.97	100%	4,687,182.08	271,386,994.39	100%	13,197,442.64

The analysis of the closing balance of bad debt provision on other receivables is as follows:

	The Group		The Company	
	2006	2005	2006	2005
Opening balance	137,428,337.69	7,083,307.99	13,197,442.64	1,241,878.97
Additions from acquisition of target companies through new share issuance	-	122,544,318.15	-	-
Additions from acquisition of target assets through new share issuance	-	1,253,959.52	-	1,253,959.52
Additions from acquisition of subsidiaries	-	297,074.87	-	-
Additions from merger of Baosteel Chemical	-	-	-	5,315.09
Additions from acquisition of partial assets and debts of Baosteel International	-	-	-	8,589,456.06
Provision of the year	22,173,211.20	10,564,894.48	481,874.92	4,605,555.88
Recovery of written-off debts for the year	154,000.00	-	154,000.00	-
Reversal of the year	(7,148,899.24)	(4,315,217.32)	(8,250,935.48)	(2,498,722.88)
Bad debt written-off for the year	(895,200.00)	-	(895,200.00)	-
Closing balance	151,711,449.65	137,428,337.69	4,687,182.08	13,197,442.64

The closing balance of other receivables from the five largest debtors for the Group totaled Rmb 614,906,404.89 versus Rmb 306,076,920.27 in 2005, accounting for 61.26% of total other receivables, or 49.97% in 2005. Likewise, the Company's top five debtors for other receivables in 2006 totaled Rmb 91,125,192.10, versus Rmb 203,747,266.57 in 2005, or 83.47% of total other receivables, and, in 2005, 75.08%. Except for the receivables of Rmb 57,269,342.79 (in 2005: Rmb 1,435.00) of Baosteel Group Corp., no balance is due from a shareholder who holds 5% or more of the Company's shares or voting power.

(Rmb)

## (7) Payment in advance

Aging analysis of payment in advance is as follows:

	The Group		The Company	
	Dec. 31, 2006	Dec. 31, 2005	Dec. 31, 2006	Dec. 31, 2005
Within 1 year	3,466,598,503.45	3,328,998,794.71	834,452,026.74	1,305,561,659.91
1-2 years	40,087,208.39	29,629,969.53	27,285,624.74	9,331,913.70
Total	3,506,685,711.84	3,358,628,764.24	861,737,651.48	1,314,893,573.61

Except for receivables due from the holding company, Baosteel Group Corp. (see table below), no balance is due from a shareholder who holds 5% or more of the Company's shares or voting power. The closing balance due from related companies are as follows:

	The Group		The Company	
	Dec. 31, 2006	Dec. 31, 2005	Dec. 31, 2006	Dec. 31, 2005
Baosteel Group Corp.	-	12,182.45	-	12,182.45
Baosteel International and its subsidiaries	-	-	129,981,291.95	111,511,066.07
Ningbo Baoxin	-	-	3,829,268.94	24,466,910.31
Huangshi Coating & Galvanizing	-	-	29,659,041.79	47,029,533.03
Howa Trading Co., Ltd. (Japan)	-	-	3,936,000.00	7,529,892.48
Baosteel Trading Europe GmbH	-	-	-	4,162,324.35
BNA Auto Steel Sheets Co., Ltd	141,397,475.23	57,937,635.03	-	-
Baosteel Group Shanghai Pudong Steel Co., Ltd and its subsidiaries	121,702,543.21	93,593,794.56	73,766,213.62	17,223,951.00
Baosteel Group Enterprise Development Corporation and its subsidiaries	450,661.08	19,124,110.64	450,651.78	6,003,000.00
Shanghai Baosteel Engineering Tech Co., Ltd. and its subsidiaries	92,731,607.58	158,905,268.22	28,371,408.25	4,834,728.23
Baosteel Group Shanghai No. 1 Steel Co., Ltd. and its subsidiaries	9,394,797.18	57,775,970.78	-	-
Shanghai Baosteel Technology and Economics Development Co., Ltd. and its subsidiaries	41,066,449.10	46,439,578.91	-	-
Baosteel Group Shanghai Meishan Co., Ltd. and its subsidiaries	32,543,132.09	16,556,449.48	10,491,160.15	-
Baosteel Group Nantong Steel Manufacturing Co., Ltd.	9,809,080.32	-	-	-
Baosteel Group Shanghai No. 2 Steel Co., Ltd. and its subsidiaries	51,094,237.15	-	-	-
Others	3,866,079.54	4,653,557.82	3,511,585.00	2,261,027.43
Total	504,056,062.48	454,998,547.89	283,996,621.48	225,034,615.35

## Notes to the Financial Statements (Continued)

31st December, 2006

## V. Explanatory Notes to Major Accounting Items (Continued)

## (8) Inventories

The Group

	Dec. 31, 2006			Dec. 31, 2005		
	Book balance	Provision for diminution in value	Net book value	Book balance	Provision for diminution in value	Net book value
Raw material	11,519,492,706.08	5,794,304.52	11,513,698,401.56	8,443,764,413.13	152,842,973.72	8,290,921,439.41
Work in progress	7,201,682,113.39	32,829,222.23	7,168,852,891.16	6,104,295,489.19	372,106,335.90	5,732,189,153.29
Finished products	10,433,818,797.33	100,800,540.20	10,333,018,257.13	8,905,211,943.15	315,156,363.77	8,590,055,579.38
Spare parts and others	2,580,085,935.59	81,105,572.38	2,498,980,363.21	2,461,846,071.85	28,722,100.91	2,433,123,970.94
Total	31,735,079,552.39	220,529,639.33	31,514,549,913.06	25,915,117,917.32	868,827,774.30	25,046,290,143.02

The Company

	Dec. 31, 2006			Dec. 31, 2005		
	Book balance	Provision for diminution in value	Net book value	Book balance	Provision for diminution in value	Net book value
Raw material	8,715,353,865.65	4,924,296.79	8,710,429,568.86	6,657,118,695.88	104,764,271.30	6,552,354,424.58
Work in progress	5,486,712,329.96	29,381,597.15	5,457,330,732.81	4,314,036,156.23	245,709,058.76	4,068,327,097.47
Finished products	1,748,206,150.45	21,727,951.10	1,726,478,199.35	1,602,546,132.92	195,958,567.18	1,406,587,565.74
Spare parts and others	2,175,762,201.67	81,105,572.38	2,094,656,629.29	2,078,518,041.60	28,524,938.33	2,049,993,103.27
Total	18,126,034,547.73	137,139,417.42	17,988,895,130.31	14,652,219,026.63	574,956,835.57	14,077,262,191.06

The analysis of provisions for reductions in the value of inventories is as follows:

	The Group		The Company	
	2006	2005	2006	2005
Opening balance	868,827,774.30	8,332,579.21	574,956,835.57	7,528,273.21
Additions from acquisition of target companies through new share issuance	-	368,984,760.10	-	-
Additions from acquisition of subsidiaries	-	1,266,340.35	-	-
Additions from accounting of associates as subsidiaries	-	140,025.61	-	-
Additions from the merger of Baosteel Chemical	-	-	-	3,539,374.63
Additions from acquisition of partial assets and debts of Baosteel International	-	-	-	30,966,637.33
Provision of the year	109,951,282.24	944,702,612.49	68,892,159.70	716,063,609.12
Reversal of the year	(758,455,457.21)	(454,598,543.46)	(506,203,124.23)	(183,141,058.72)
Decrease due to transfer of partial assets and debts	-	-	(506,453.62)	-
Foreign currency translation difference	206,040.00	-	-	-
Closing balance	220,529,639.33	868,827,774.30	137,139,417.42	574,956,835.57

(Rmb)

## (9) Deferred expenses

The Group

	Dec. 31, 2006	Dec. 31, 2005
Fuel expense	3,193,758.30	3,042,465.40
Lease expense	1,893,277.45	1,862,736.46
Insurance	69,799.26	646,051.36
Others	1,432,627.92	2,730,046.87
Total	6,589,462.93	8,281,300.09

## (10) Long-term investments

The Group

	Jan. 1, 2006	Addition for the year	Reduction for the year	Dec. 31, 2006
Long-term equity investment				
Equity investment accounted by cost method	1,230,000.00	-	-	1,230,000.00
Other equity investment accounted by cost method	594,146,862.90	28,878,363.80	(7,080,000.00)	615,945,226.70
Investment in subsidiaries not yet merged	446,087,943.04	97,631,285.97	(8,270,903.49)	535,448,325.52
Investment in jointly controlled entities not yet merged	112,721,210.83	(6,100,237.80)	-	106,620,973.03
Investment in associates	937,482,053.24	454,955,687.12	(326,092,024.80)	1,066,345,715.56
Equity investment difference	518,435,843.43	-	(131,359,235.35)	387,076,608.08
	2,610,103,913.44	575,365,099.09	(472,802,163.64)	2,712,666,848.89
Long-term debt investment				
Bond investment	261,333,413.17	-	(261,333,413.17)	-
	261,333,413.17	-	(261,333,413.17)	-
Less: Provision for impairment of long-term investment	-	-	-	-
	2,871,437,326.61	575,365,099.09	(734,135,576.81)	2,712,666,848.89

The Company

	Jan. 1, 2006	Addition for the year	Reduction for the year	Dec. 31, 2006
Long-term equity investment				
Equity investment accounted by cost method	980,000.00	-	-	980,000.00
Other equity investment accounted by cost method	112,282,213.00	-	-	112,282,213.00
Investment in subsidiaries	15,694,450,781.96	2,801,071,153.17	(1,371,941,154.13)	17,123,580,781.00
Investment in jointly controlled entities	1,212,696,123.29	263,510,569.11	-	1,476,206,692.40
Investment in associates	175,462,533.19	128,067,818.48	(582,903.96)	302,947,447.71
Equity investment difference	617,313,761.41	-	(153,751,993.70)	463,561,767.71
	17,813,185,412.85	3,192,649,540.76	(1,526,276,051.79)	19,479,558,901.82
Less: Provision for impairment of long-term investment	-	-	-	-
	17,813,185,412.85	3,192,649,540.76	(1,526,276,051.79)	19,479,558,901.82

## Notes to the Financial Statements (Continued)

31st December, 2006

## V. Explanatory Notes to Major Accounting Items (Continued)

Long-term equity investment includes:

## (i) Stock investment

The Group

Stock investment accounted by cost method

Names of the companies invested	Type of shareholding	Number of shares	Percentage of shares	Investment
Yangtze River Economy United Development Group ("YUD Group")	legal person share	700,000	very small	980,000.00
Shanghai Municipal Raw Water Co., Ltd ("Raw Water Co.,")	legal person share	25,000	very small	125,000.00
Shenenergy Co., Ltd (Shenenergy Co.,)	legal person share	25,000	very small	125,000.00
Total				1,230,000.00

The Company

Stock investment accounted by cost method

Names of the companies invested	Type of shareholding	Number of shares	Percentage of shares	Investment
YUD Group	legal person share	700,000	very small	980,000.00

(Rmb)

## (ii) Other equity investments accounted by the cost method

## The Group

Names of enterprises invested		Investment time limit	Percentage of equity	Investment Dec. 31, 2006
Baovale Mineracao SA	N(1)	long term	50%	103,282,213.00
Taiyuan Baoyuan Chemical Co., Ltd.		20 years	15%	9,000,000.00
CISDI Engineering Co., Ltd.		long term	8%	9,508,999.34
Jinchuan Group Automation Engineering Co., Ltd.		long term	7.128%	1,000,000.00
Dandong Harima Refractories Co., Ltd.	N(2)	15 years	20%	20,000,000.00
Shanghai Datun Energy Resources Co., Ltd.		long term	2.34%	11,000,000.00
Zhongjijing Investment Consultancy Stock Co., Ltd		long term	5%	3,000,000.00
Kailuan Clean Coal Co., Ltd.		long term	1.30%	7,000,000.00
Datong Coal Co., Ltd.		long term	0.63%	5,000,000.00
Shanxi Lu'an Environmental Protection & Energy Development Co., Ltd.		long term	1.46%	10,000,000.00
Ningbo Port Beilun Stock Co., Ltd.		long term	2.27%	15,371,426.00
Shanghai Hanyang Ship Container Spare Parts Manufactory Co., Ltd.	N(2)	30 years	20%	3,311,720.00
Anhui Hui Merchant Stock Co., Ltd.		long term	3.53%	3,000,000.00
Shanghai Youth Property Management Co., Ltd.		15 years	10%	100,000.00
China Resources Land Co., Ltd. (Beijing)		long term	0.12%	1,618,750.00
Shanghai Bao Yin Metal Decorating Co., Ltd.		50 years	10%	8,742,000.00
Shanghai No. 5 Steel Logistics Co., Ltd.		30 years	10%	5,862,500.00
Henan Longyu Energy Co., Ltd.		long term	12.96%	370,269,254.56
Shanghai CIMC Baowell Industries Co., Ltd		50 years	13.16%	28,878,363.80
Total				615,945,226.70

## The Company

Names of enterprises invested		Investment time limit	Percentage of equity	Investment Dec. 31, 2006
Baovale Mineracao SA	N(1)	long term	50%	103,282,213.00
Taiyuan Baoyuan Chemical Co., Ltd.		20 years	15%	9,000,000.00
Total				112,282,213.00

N(1) As the Group has no actual control or significant impacts on the operation policies and financial decisions of Baovale Mineracao SA, it only charges a fixed return of a certain proportion based on related investment agreement. Therefore, the investment in Baovale Mineracao SA is reflected as long-term equity investment and accounted by the cost method.

N(2) The Group has no significant impacts on the companies mentioned above, thus they are accounted by the cost method.

## Notes to the Financial Statements (Continued)

31st December, 2006

## V. Explanatory Notes to Major Accounting Items (Continued)

## (iii) Investment in subsidiaries not yet merged/subsidiaries accounted by the equity method

## The Group

Names of entities invested	Invested time limit	Percentage out of the registered capital	Initial investment (RMB)	Total additional investment	Investment cost increase/deduction of the year	Investment cost Dec. 31, 2006
Lubao Industry & Trade	30 years	100%	1,650,000.00	-	-	1,650,000.00
Lubao Sales Office	long term	100%	500,000.00	-	-	500,000.00
Finance Company	long term	62.1%	372,864,751.93	-	-	385,943,944.26
Chemical Sales Department	N(1)	100%	2,000,000.00	-	(2,000,000.00)	-
			377,014,751.93	-	(2,000,000.00)	388,093,944.26

N (1) :The Chemical Sales Department has finished the accounting for the year:

## The Company

Names of entities invested	Invested time limit	Percentage out of the registered capital	Initial investment (RMB)	Total additional investment	Investment cost Increase/deduction of the year	Investment cost Dec. 31, 2006
Yantai Lubao	17 years	79.82%	243,248,705.24	-	-	243,248,705.24
Huangshi Coating & Galvanizing	20 years	39.37%	12,254,475.04	-	-	12,254,475.04
Baosteel International	long term	100%	4,735,670,804.11	-	-	4,735,670,804.11
Meisteel Co.,	61 years	74.01%	6,609,321,102.70	-	-	6,609,321,102.70
Ningbo Baoxin	30 years	54%	1,786,187,133.16	-	-	1,786,187,133.16
Baosight Software	see N(5) (16)	55.50%	241,213,064.59	-	(7,250,729.08)	233,962,335.51
Baosteel America	long term	100%	42,567,875.48	-	-	42,567,875.48
Howa Trading (Japan)	long term	100%	154,073,767.03	-	-	154,073,767.03
Baodao Trading (HK)	long term	100%	82,340,043.29	-	-	82,340,043.29
Baosteel Europe	long term	100%	93,801,781.59	-	-	93,801,781.59
Baosteel Singapore	long term	100%	76,419,617.09	-	-	76,419,617.09
Bao-Trans Enterprises	long term	100%	29,882,599.80	-	-	29,882,599.80
Baosteel Mining (Bao Australia)	see N(4)	100%	164,045,478.85	-	(164,045,478.85)	-
Baosteel Trading (Bao Brazil)	long term	100%	526,327.52	-	-	526,327.52
Suzhou Baohua	50 years	60%	132,000,000.00	45,000,000.00	45,000,000.00	177,000,000.00
No. 5 Steel Gas	20years	94.5%	117,190,067.55	-	-	117,190,067.55
No. 5 Steel Pudong Intl Trade	45years	90%	83,656,040.92	-	-	83,656,040.92
Dongguan Baote	7years	10%	3,577,208.96	-	-	3,577,208.96
Anhui Wanbao	long term	8%	3,024,787.66	-	-	3,024,787.66
Bsteel	long term	38%	29,098,672.57	-	-	29,098,672.57
Baosteel Special Steel	20years	100%	50,000,000.00	-	50,000,000.00	50,000,000.00
Chemical Sales Department	N(1)	100%	2,000,000.00	-	(2,000,000.00)	-
			14,692,099,553.15	45,000,000.00	(78,296,207.93)	14,563,803,345.22

N(1):The Chemical Sales Department has finished the accounting for the year:

(Rmb)

Adjustment of equity					
Gain and loss of the year / disposal and transfer	Cash bonus of the year	Total gain and loss Dec. 31, 2006	Provision for investment		Investment in subsidiaries Dec. 31, 2006
			Increase and deduction of the year /disposal and transfer	Total increase/deduction	
9,784,004.40	(4,029,170.73)	13,386,210.25	-	1,090,723.04	16,126,933.29
(80,554.90)	-	666,406.50	-	-	1,166,406.50
91,828,105.15	-	139,165,091.70	(3,900,268.68)	(6,954,050.23)	518,154,985.73
(2,076,384.69)	-	-	(165,348.07)	-	-
99,455,169.96	(4,029,170.73)	153,217,708.45	(4,065,616.75)	(5,863,327.19)	535,448,325.52

Adjustment of equity							
Reduction/disposal and transfer due to untradable share structure reform of shanghai Baosight	Gain and loss of the year	Cash bonus of the year	Total increase/ deduction Dec. 31, 2006	Provision for investment			Investment in subsidiaries Dec. 31, 2006
				Reduction/disposal and transfer due to untradable share structure reform of shanghai Baosight	Increase and deduction of the year	Total increase/ deduction	
-	122,470,645.58	(39,861,657.87)	247,518,607.72	-	528,520.60	1,834,646.68	492,601,959.64
-	5,263,402.17	-	31,434,205.42	-	-	379,103.69	44,067,784.15
-	1,279,657,944.40	(765,597,532.87)	1,026,343,149.59	-	33,561,643.64	70,971,927.90	5,832,985,881.60
-	678,227,843.16	(198,265,611.03)	1,066,395,614.98	-	269.23	7,075,625.23	7,682,792,342.91
-	60,501,298.54	-	(586,442,811.49)	-	-	-	1,199,744,321.67
(608,135.92)	57,785,223.61	-	49,512,557.34	(90,624.18)	2,820,800.87	3,862,194.14	287,337,086.99
-	103,562,094.29	-	148,868,371.24	-	(3,874,065.74)	(3,874,065.74)	187,562,180.98
-	75,904,273.24	-	94,052,819.70	-	(26,150,806.61)	(26,150,806.61)	221,975,780.12
-	111,390,839.55	(162,605,861.49)	23,677,203.94	-	(5,024,687.98)	(5,024,687.98)	100,992,559.25
-	134,564,893.35	-	190,082,823.58	-	44,747,376.41	44,747,376.41	328,631,981.58
-	59,135,416.76	-	83,575,014.02	-	(5,111,267.02)	(5,111,267.02)	154,883,364.09
-	40,842,455.89	-	69,878,858.99	-	(2,643,726.65)	(2,643,726.65)	97,117,732.14
-	(86,269,676.80)	-	-	-	-	-	-
-	150,893.20	-	95,401.19	-	106,919.02	106,919.02	728,647.73
-	16,308,198.39	-	51,561,213.61	-	2,896.80	3,516,076.38	232,077,289.99
-	826,426.95	-	3,565,530.04	-	-	-	120,755,597.59
-	5,112,658.64	(28,689,213.01)	(26,256,070.06)	-	-	-	57,399,970.86
-	804,883.82	(429,371.92)	419,653.21	-	-	-	3,996,862.17
-	295,865.37	(255,205.15)	62,328.25	-	-	4,823.99	3,091,939.90
-	571,700.49	-	(4,261,174.93)	-	-	-	24,837,497.64
-	-	-	-	-	-	-	50,000,000.00
(2,076,384.69)	-	-	-	(165,348.07)	-	-	-
(2,684,520.61)	2,667,107,280.60	(1,195,704,453.34)	2,470,083,296.34	(255,972.25)	38,963,872.57	89,694,139.44	17,123,580,781.00

## Notes to the Financial Statements (Continued)

31st December, 2006

## V. Explanatory Notes to Major Accounting Items (Continued)

## (iv) Investment in associates not yet merged / jointly controlled entities accounted by the equity method

## The Group

Names of entities invested	Invested time limit	Percentage out of the registered capital	Initial investment (RMB)	Investment cost Increase/ deduction of the year	Investment cost Dec. 31, 2006
Shanghai Kebao	20 years	50%	37,011,238.50	-	37,011,238.50
Niagara Machinery	20 years	50%	74,917,134.92	-	74,917,134.92
			111,928,373.42	-	111,928,373.42

## The Company

Names of entities invested	Invested time limit	Percentage out of the registered capital	Initial investment (RMB)	Investment cost Increase/ deduction of the year	Investment cost Dec. 31, 2006
BNA Auto Steel Sheet	20 years	50%	1,500,000,000.00	-	1,500,000,000.00
Bao-Island Enterprises	long term	50%	143,084,132.00	-	143,084,132.00
			1,643,084,132.00	-	1,643,084,132.00

(Rmb)

Adjustment of equity						Investment in associates not yet merged Dec. 31, 2006
Increase/deduction of the year	Cash bonus of the year	Total increase/deduction Dec. 31, 2006	Provision for investment			
			Increase and deduction of the year	Total increase/deduction		
(3,379,139.81)	-	(3,379,139.81)	-	-	33,632,098.69	
(2,721,097.99)	-	(1,928,260.58)	-	-	72,988,874.34	
(6,100,237.80)	-	(5,307,400.39)	-	-	106,620,973.03	

Adjustment of equity						Investment in jointly controlled entities Dec. 31, 2006
Increase/deduction of the year	Cash bonus of the year	Total increase/deduction Dec. 31, 2006	Provision for investment			
			Increase and deduction of the year	Total increase/deduction		
178,575,968.36	-	(263,152,117.61)	-	(3,027,142.34)	1,233,820,740.05	
93,349,104.15	-	107,716,323.75	(8,414,503.40)	(8,414,503.40)	242,385,952.35	
271,925,072.51	-	(155,435,793.86)	(8,414,503.40)	(11,441,645.74)	1,476,206,692.40	

## Notes to the Financial Statements (Continued)

31st December, 2006

## V. Explanatory Notes to Major Accounting Items (Continued)

## (v) Investment in associates accounted by equity method

## The Group

Names of entities invested	Invested time limit	Percentage out of the registered capital	Initial investment (RMB)	Total addition investment	Investment cost increase/ deduction of the year due to the accounting of associates transferred from subsidiaries	Investment cost Dec. 31, 2006
Welding Co.,	20 years	38%	46,170,000.00	-	-	46,170,000.00
STAL Precision	50 years	40%	122,004,541.93	65,472,880.00	65,472,880.00	187,477,421.93
Wenzhou Baolong	N(1)	40%	200,000.00	-	(200,000.00)	-
SCBC	50 years	13.16%	61,177,044.83	-	(61,177,044.83)	-
Henan Zhenglong Coal Co.,	50 years	35%	171,409,000.00	-	-	171,409,000.00
Guangzhou Wanbao	50 years	25%	24,840,000.00	-	-	24,840,000.00
Henan Pingbao Coal	50 years	40%	120,000,000.00	80,000,000.00	80,000,000.00	200,000,000.00
Tianjin BCM	50 years	40%	56,000,000.00	-	-	56,000,000.00
Baojiang Shipping	20 years	40%	16,000,000.00	-	-	16,000,000.00
Renwei Software	N(4)	41.33%	9,104,755.00	-	5,131,591.00	5,131,591.00
Wuxi Baomit	50 years	51%	32,522,976.15	-	-	32,522,976.15
Anhui Qingyang Mining Co.,	30 years	35%	5,250,000.00	-	-	5,250,000.00
			664,678,317.91	145,472,880.00	89,227,426.17	744,800,989.08

N(1): Wenzhou Baolong was disposed and transferred out this year.

## The Company

Names of entities invested	Invested time limit	Percentage out of the registered capital	Initial investment (RMB)	Total addition investment	Investment cost increase/ deduction of the year	Investment cost Dec. 31, 2006
Welding Co.,	20 years	28%	34,020,000.00	-	-	34,020,000.00
STAL Precision	50 years	40%	122,004,541.93	65,472,880.00	65,472,880.00	187,477,421.93
Wenzhou Baolong	N(1)	40%	200,000.00	-	(200,000.00)	-
			156,224,541.93	65,472,880.00	65,272,880.00	221,497,421.93

N (1): Wenzhou Baolong was disposed and transferred out this year.

Note: Shanghai Baosteel & Arcelor Laser Welding Company Ltd ("Welding Company")  
Shanghai STAL Precision Stainless Steel Co., Ltd. ("STAL Precision")  
Wenzhou Baolong Trading Co., Ltd. ("Wenzhou Baolong")  
Shanghai CIMC Baowell Industries Co., Ltd. ("SCBC")  
Henan Zhenglong Coal Co., Ltd. ("Heinan Zhenglong")  
Guangzhou Wanbaojing Automotive Spare Parts Co., Ltd. ("Guangzhou Wanbao")    Heinan Pingbao Coal Co., Ltd. ("Heinan Pingbao")  
Tianjin BCM Distribution Co., Ltd. (Tianjin BCM)  
Shanghai Baojiang Shipping Co., Ltd. (Baojiang Shipping)  
Shanghai Renwei Software Co., Ltd (Renwei Software)  
Wuxi Baomit Steel Processing and Delivery Co., Ltd. ("Wuxi Baomit")  
Anhui Qingyang Baohong Mining Co., Ltd. ("Anhui Qingyang")

(Rmb)

Adjustment of equity								Investment in associates Dec. 31, 2006
Increase and deduction of the year due to the accounting of associates transferred from subsidiaries	Cash bonus of the year	Disposal and transfer	Total increase/ deduction Dec. 31, 2006	Provision for investment				
				Increase and deduction of the year	Disposal and transfer	Total increase/ deduction		
910,457.41	-	-	(8,511,555.94)	-	-	6,048.78	37,664,492.84	
61,965,869.64	-	-	87,683,077.13	(30,009.32)	-	34,164.45	275,194,663.51	
(11,785.24)	(46,322.69)	(336,581.27)	-	-	-	-	-	
-	-	(43,248,077.84)	-	-	3,213,041.86	-	-	
208,722,234.64	(207,205,288.00)	-	202,018,578.72	9,141.83	-	9,141.83	373,436,720.55	
10,594,711.21	-	-	3,913,711.21	-	-	-	28,753,711.21	
-	-	-	-	-	-	-	200,000,000.00	
288,070.93	-	-	(11,098,648.45)	-	-	2,240,000.00	47,141,351.55	
3,914,961.92	(5,810,964.87)	-	8,221,266.29	-	-	579,303.72	24,800,570.01	
(2,397,352.26)	-	-	(2,397,352.26)	-	-	-	2,734,238.74	
20,219,125.24	(11,280,787.16)	-	38,902,214.15	-	-	-	71,425,190.30	
165,790.12	-	-	(55,223.15)	-	-	-	5,194,776.85	
304,372,083.61	(224,343,362.72)	(43,584,659.11)	318,676,067.70	(20,867.49)	3,213,041.86	2,868,658.78	1,066,345,715.56	

Adjustment of equity								Investment in associates Dec. 31, 2006
Increase and deduction of the year	Cash bonus of the year	Disposal and transfer	Total increase/ deduction Dec. 31, 2006	Provision for investment				
				Increase and deduction of the year	Disposal and transfer	Total increase/ deduction		
670,863.40	-	-	(6,273,264.58)	-	-	6,048.78	27,752,784.20	
61,965,869.64	-	-	87,683,077.13	(30,009.32)	-	34,164.45	275,194,663.51	
(11,785.24)	(46,322.69)	(336,581.27)	-	-	-	-	-	
62,624,947.80	(46,322.69)	(336,581.27)	81,409,812.55	(30,009.32)	-	40,213.23	302,947,447.71	

Where the equity method of accounting has been adopted, there is no significant difference in the accounting policies of the Group and all its subsidiaries, jointly controlled entities and associates, which are not yet merged. There is no significant difference in the accounting policies of the Company and all its subsidiaries, jointly controlled entities and associates, and there is no great limit on the investment cashing of this long-term investment and investment income repatriation.

## Notes to the Financial Statements (Continued)

31st December, 2006

## V. Explanatory Notes to Major Accounting Items (Continued)

## (vi) Equity investment difference

## The Group

Names of the entities invested	Cause of formation	Years of amortizatopm	Initial amount	Amortized amount Jan. 1, 2006	Amortization for the year	Amortized amount Dec. 31, 2006
Huangshi Coating & Galvanizing	premium acquisition	5 years	60,620,157.13	14,683,463.38	(14,683,463.38)	-
Baosteel International	premium acquisition	5 years	215,370,162.36	186,654,140.71	(43,074,032.47)	143,580,108.24
Meisteel	premium acquisition	5 years	79,325,610.21	68,748,862.18	(15,865,122.04)	52,883,740.14
Ninbo Baoxin	premium acquisition	5 years	72,928,375.23	63,204,591.87	(14,585,675.04)	48,618,916.83
Baodao Trading	premium acquisition	5 years	45,084,063.16	39,072,854.74	(9,016,812.64)	30,056,042.10
Baosteel Europe	premium acquisition	5 years	32,011,552.66	27,743,345.64	(6,402,310.53)	21,341,035.11
Bao-Islang Enterprises	premium acquisition	5 years	80,656,013.56	69,901,878.42	(16,131,202.72)	53,770,675.70
Baoli Integration	premium acquisition	10 years	10,474.74	6,372.13	(1,047.49)	5,324.64
Baojing Information	premium acquisition	10 years	2,042,882.71	1,227,620.54	(204,288.23)	1,023,332.31
Shanghai Shenjin	premium acquisition	5 years	8,172,099.72	3,268,839.89	(1,634,419.94)	1,634,419.95
Niagara Machinery	premium acquisition	5 years	48,804,304.37	43,923,873.93	(9,760,860.87)	34,163,013.06
			645,025,695.85	518,435,843.43	(131,359,235.35)	387,076,608.08

## The Company

Names of the entities invested	Cause of formation	Years of amortizatopm	Initial amount	Amortized amount Jan. 1, 2006	Amortization for the year	Amortized amount Dec. 31, 2006
Huangshi Coating & Galvanizing	premium acquisition	5 years	60,620,157.13	14,683,463.38	(14,683,463.38)	-
Baosteel International	premium acquisition	5 years	417,348,589.41	361,702,110.82	(83,469,717.88)	278,232,392.94
Meisteel	premium acquisition	5 years	79,325,610.21	68,748,862.18	(15,865,122.04)	52,883,740.14
Ninbo Baoxin	premium acquisition	5 years	72,928,375.23	63,204,591.87	(14,585,675.04)	48,618,916.83
Baodao Trading	premium acquisition	5 years	45,084,063.16	39,072,854.74	(9,016,812.64)	30,056,042.10
Bao-Islang Enterprises	premium acquisition	5 years	80,656,013.56	69,901,878.42	(16,131,202.72)	53,770,675.70
			755,962,808.70	617,313,761.41	(153,751,993.70)	463,561,767.71

By December 31, 2006, the total amount of the Group's long-term and short-term investments reached Rmb2,724,170,240.43, accounting for 3.32% of the Group's net assets. Administrators of the Company consider that there is no significant limit to the cashing of the investment of the Group.

(Rmb)

## (11) Fixed Assets

## The Group

	Buildings & plants	Machinery & equipment	Transport vehicles	Office & other equipment	Expenditures incurred on major repair and improvement of rented fixed assets	Total
Cost						
At 1st January 2006	35,753,431,366.70	106,151,609,198.23	12,882,554,760.07	12,412,683,403.25	-	167,200,278,728.25
Acquisition	95,634,760.24	311,661,798.69	147,936,182.93	134,125,119.71	4,653,558.51	694,011,420.08
Transferred from construction-in-progress	2,471,655,746.06	10,675,159,331.05	532,354,697.33	881,301,390.08	-	14,560,471,164.52
Reclassification	1,053,799,508.79	(2,274,357,908.58)	929,734,256.90	290,824,142.89	-	-
Transferred from acquisition of subsidiaries	60,398.96	-	583,418.27	687,133.45	-	1,330,950.68
Acquisition from associates	-	-	143,065.00	881,074.80	-	1,024,139.80
Disposals to associates	(1,267,460.00)	(20,757,483.56)	(950,667.00)	(11,947,162.65)	-	(34,922,773.21)
Disposal	(240,001,521.59)	(1,485,649,320.59)	(267,677,062.70)	(915,811,168.36)	-	(2,909,139,073.24)
Reduction from the accounting of associates as subsidiaries	(662,500.00)	-	(413,438.03)	(1,707,269.14)	-	(2,783,207.17)
Reduction from the disposal of subsidiaries	-	(148,644,143.99)	(49,548,048.01)	(4,560,718.95)	-	(202,752,910.95)
Other reductions	(223,047,266.12)	(693,268,000.86)	(28,942,671.40)	(66,753,814.29)	-	(1,012,011,752.67)
Foreign currency translation difference	(7,188,163.79)	-	(23,934,179.88)	(368,243.92)	-	(31,490,587.59)
At Dec. 31, 2006	38,902,414,869.25	112,515,753,470.39	14,121,840,313.48	12,719,353,886.87	4,653,558.51	178,264,016,098.50
Accumulated depreciation						
At 1st January 2006	12,891,609,232.75	56,061,966,702.99	9,593,393,346.57	8,862,026,292.38	-	87,408,995,574.69
Provision for the year	1,890,736,814.13	7,927,911,396.88	1,076,775,065.53	1,401,959,718.05	1,700,005.32	12,299,082,999.91
Reclassification	18,889,963.23	(568,373,524.11)	468,331,969.69	81,151,591.19	-	-
Additions from acquisition of subsidiaries	39,353.25	-	548,448.85	186,125.15	-	773,927.25
Disposal to associates	(621,637.40)	(17,956,937.62)	(912,640.32)	(9,388,243.67)	-	(28,879,459.01)
Write-off	(151,434,311.69)	(1,348,879,456.56)	(149,808,831.71)	(816,934,103.24)	-	(2,467,056,703.20)
Reduction from the accounting of associates as subsidiaries	(662,485.28)	-	(124,114.08)	(868,772.96)	-	(1,655,372.32)
Reduction from the disposal of subsidiaries	-	(14,164,034.39)	(4,721,344.81)	(672,952.58)	-	(19,558,331.78)
Other reductions	(209,518,384.45)	(510,420,636.81)	(28,995,049.61)	(64,000,461.32)	-	(812,934,532.19)
Foreign currency translation difference	(785,972.22)	-	(10,671,780.68)	(317,174.64)	-	(11,774,927.54)
At Dec. 31, 2006	14,438,252,572.32	61,530,083,510.38	10,943,815,069.43	9,453,142,018.36	1,700,005.32	96,366,993,175.81
Net book value of fixed assets						
At Dec. 31, 2006	24,464,162,296.93	50,985,669,960.01	3,178,025,244.05	3,266,211,868.51	2,953,553.19	81,897,022,922.69
At Jan. 1, 2006	22,861,822,133.95	50,089,642,495.24	3,289,161,413.50	3,550,657,110.87	-	79,791,283,153.56
Provision of impairment loss						
At Jan. 1, 2006	32,634,723.65	16,164,352.81	396,623.60	2,747,027.36	-	51,942,727.42
Provision	-	2,183,203.41	397,360.03	417,638.85	-	2,998,202.29
Disposal and write-off	(5,483,701.98)	(6,957,470.80)	(2,310.40)	(395,784.44)	-	(12,839,267.62)
Foreign currency translation difference	(12,348,404.97)	-	-	-	-	(12,348,404.97)
At Dec. 31, 2006	14,802,616.70	11,390,085.42	791,673.23	2,768,881.77	-	29,753,257.12
Net book value of fixed assets						
At Dec. 31, 2006	24,449,359,680.23	50,974,279,874.59	3,177,233,570.82	3,263,442,986.74	2,953,553.19	81,867,269,665.57
At Jan. 1, 2006	22,829,187,410.30	50,073,478,142.43	3,288,764,789.90	3,547,910,083.51	-	79,739,340,426.14

As at the 31st December 2006, among the above fixed assets four freighters totaling Rmb 378,245,619.30 in net book value terms (year 2005: Rmb 408,497,383.60) and buildings and machinery & equipment with a total net book value of Rmb 72,973,489.00 (year 2005: Rmb 61,028,000.00) are being mortgaged for long-term mortgage loan (Note V (28)); Fixed assets mortgaged for short-term mortgage loan (Note V (18)) amount to Rmb 38,750,000.00 in net book value terms.

As at the 31st December 2006, the property-user rights of the buildings and plants, which are worth Rmb 4,570,788,041.54 in total, are still in the process of being transferred to the Group, the management of which believe there exist no legal or other difficulties in securing the property-user rights once the Group has gone through registration procedures and paid all fees.

## Notes to the Financial Statements (Continued)

31st December, 2006

## V. Explanatory Notes to Major Accounting Items (Continued)

## The Company

	Buildings & plants	Machinery & equipment	Transport vehicles	Office & other equipment	Total
Cost					
At Jan. 1, 2006	30,004,851,515.34	91,911,388,715.67	11,559,745,882.50	11,070,459,451.61	144,546,445,565.12
Acquisition	80,435,965.60	128,817,698.57	60,481,153.90	73,321,153.74	343,055,971.81
Transferred from construction in progress	1,668,724,455.14	6,882,642,414.60	503,760,899.04	589,666,996.35	9,644,794,765.13
Reduction from transfer of partial assets and debts	-	-	-	(1,274,153.64)	(1,274,153.64)
Disposal	(204,843,890.89)	(1,013,055,511.58)	(108,786,435.24)	(797,380,917.93)	(2,124,066,755.64)
Other reductions	(223,047,266.12)	(562,576,575.21)	(28,942,671.40)	(66,753,814.29)	(881,320,327.02)
Dec. 31, 2006	31,326,120,779.07	97,347,216,742.05	11,986,258,828.80	10,868,038,715.84	151,527,635,065.76
Accumulated depreciation					
At Jan. 1, 2006	11,214,782,055.36	50,911,743,363.58	9,003,100,743.80	8,181,787,010.69	79,311,413,173.43
Charge for the year	1,571,180,704.79	6,539,173,802.15	839,612,111.16	1,200,314,613.26	10,150,281,231.36
Reduction from transfer of partial assets and debts	-	-	-	(84,346.61)	(84,346.61)
Write-off	(134,397,080.81)	(888,128,882.73)	(102,707,020.48)	(755,759,491.31)	(1,880,992,475.33)
Other reductions	(209,518,384.45)	(510,420,636.81)	(27,784,964.69)	(63,719,639.65)	(811,443,625.60)
At Dec. 31, 2006	12,442,047,294.89	56,052,367,646.19	9,712,220,869.79	8,562,538,146.38	86,769,173,957.25
Net book value of fixed assets:					
At Dec. 31, 2006	18,884,073,484.18	41,294,849,095.86	2,274,037,959.01	2,305,500,569.46	64,758,461,108.51
At Jan. 1, 2006	18,790,069,459.98	40,999,645,352.09	2,556,645,138.70	2,888,672,440.92	65,235,032,391.69
Provision of impairment loss					
At Jan. 1, 2006	-	3,963,416.39	18,341.43	452,273.94	4,434,031.76
Provision	-	2,183,203.41	52,361.97	417,638.85	2,653,204.23
Disposal and write-off	-	(617,285.79)	(2,310.40)	(2,577.48)	(622,173.67)
At Dec. 31, 2006	-	5,529,334.01	68,393.00	867,335.31	6,465,062.32
Net book value of fixed assets:					
At Dec. 31, 2006	18,884,073,484.18	41,289,319,761.85	2,273,969,566.01	2,304,633,234.15	64,751,996,046.19
At Jan. 1, 2006	18,790,069,459.98	40,995,681,935.70	2,556,626,797.27	2,888,220,166.98	65,230,598,359.93

As at the 31st December 2006, the property-user rights of the buildings and plants, which are worth Rmb 4,474,805,456.11 in net book value (year 2005: Rmb 5,074,387,217.37), are still in the process of being transferred to the Company, the management of which believe there exist no legal or other difficulties in securing the property-user rights once the Company has gone through registration procedures and paid all fees.

(Rmb)

The analysis of the provision for impairment of losses of assets are as follows:

	The Group		The Company	
	Dec. 31, 2006	Dec. 31, 2005	Dec. 31, 2006	Dec. 31, 2005
Opening balance	51,942,727.42	2,282,821.45	4,434,031.76	2,282,821.45
Additions from target assets acquisition through new share issuance	-	48,894,386.30	-	-
Additions from acquisition of subsidiaries	-	339,000.00	-	-
Charge for the year	2,998,202.29	2,312,491.58	2,653,204.23	2,276,934.43
Transferred out this year	(12,839,267.62)	(1,128,923.02)	(622,173.67)	(125,724.12)
Foreign currency translation difference	(12,348,404.97)	(757,048.89)	-	-
Closing balance	29,753,257.12	51,942,727.42	6,465,062.32	4,434,031.76

As at 31st December 2006, the net book value of temporarily idle fixed assets of the Group and the Company totaled Rmb 17,827,577.10 (2005: Rmb 29,353,237.09) and Rmb 12,732,355.40 (2005: Rmb 9,816,081.40) respectively.

As at the balance sheet date, the book net value of the operating lease of fixed assets are as follows:

The Group and company

	Buildings & plants	Machinery & equipment	Transport vehicles	Office & other equipment	Total
Closing balance	6,786,498.87	7,439,054.89	-	204,616.69	14,430,170.45
Opening balance	10,811,823.34	10,899,462.82	486,969.67	334,083.52	22,532,339.35

## Notes to the Financial Statements (Continued)

31st December, 2006

## V. Explanatory Notes to Major Accounting Items (Continued)

## (12) Project goods and materials

	The Group		The Company	
	Dec. 31, 2006	Dec. 31, 2005	Dec. 31, 2006	Dec. 31, 2005
Project material	2,328,011.85	57,853,175.56	745,854.66	57,853,175.56
Project equipment	228,873,612.32	216,365,091.68	166,992,883.17	60,512,411.30
Prepayment for large equipment	337,599,161.54	395,186,550.56	337,599,161.54	190,680,746.45
	568,800,785.71	669,404,817.80	505,337,899.37	309,046,333.31

## (13) Construction in progress

## The Group

Project Names		Technology improvement & infrastructure
Opening balance		8,818,232,607.56
Addition for the year		17,692,962,892.17
Transferred to fixed assets this year		(14,560,471,164.52)
Other reductions		(52,727,763.78)
Closing balance		11,897,996,571.43
Budgeted amount		41,570,616,805.00
Funding source	Self-funding	40,090,616,805.00
	Borrowing	1,480,000,000.00
Construction cost to total budget		0.02% - 97.81%
Capitalized interest for the year		10,562,438.91

The Management of the Company considers no provision is needed for impairment losses for projects under construction before the balance sheet date. The increase of Rmb 3,079,763,963.87 in the closing balance has mainly arisen from the fact that new projects, including Baosteel's No. 3 hot strip mill, No. 5 cold-rolled steel strip, the upgrading of Baosteel's No.4 continuous caster, the tapping potentiality and upgrading of No. 2 Steel Making Plant, and the newly increased No. 2 treatment line for heavy plates, and the phase 4 project of cold-rolled stainless steel of Ningbo Baoxin, have been put into operation and transferred to fixed assets.

## The Company

Project Names		Technology improvement & infrastructure
Opening balance		5,126,509,250.79
Addition for the year		15,763,445,285.32
Transferred to fixed assets this year		(9,644,794,765.13)
Reduction from the trader of partial assets and debts		(1,547,000.00)
Other reductions		(26,903,697.06)
Closing balance		11,216,709,073.92
Budgeted amount		41,232,652,760.00
Funding source	self-funding	39,752,652,760.00
	borrowing	1,480,000,000.00
Construction cost to total budget		0.02% - 97.81%
Capitalized interest for the year		10,562,438.91

The Management of the Company considers no provision is needed for impairment losses for projects under construction before the balance sheet date. The increase of Rmb 6,090,199,823.13 in the closing balance has mainly arisen from the fact that new projects, including Baosteel's No. 3 hot strip mill, No. 5 cold-rolled steel strip, the upgrading of Baosteel's No.4 continuous caster, the tapping potentiality and upgrading of No. 2 Steel Making Plant, and the newly increased No. 2 treatment line for heavy plates, and the phase 4 project of cold-rolled stainless steel of Ningbo Baoxin, have been put into operation and transferred to fixed assets.

(Rmb)

## (14) Intangible assets

The Group

	Land-use rights	Others	Total
Opening balance	1,257,110,127.37	40,992,839.67	1,298,102,967.04
Addition for the year	77,024,078.40	17,716,028.78	94,740,107.18
Amortization for the year	(29,012,485.64)	(12,330,053.40)	(41,342,539.04)
Reduction for the year	-	(305,335.19)	(305,335.19)
Foreign currency translation difference	-	1,178.62	1,178.62
Closing balance	1,305,121,720.13	46,074,658.48	1,351,196,378.61

The Company

	Land-use rights
Opening balance	-
Addition for the year	26,117,700.00
Amortization for the year	(217,647.50)
Closing balance	25,900,052.50

The management of the Company considers no provision is needed for impairment losses for intangible assets before the balance sheet date.

## (15) Long-term deferred expenses

The Group

	Dec. 1, 2006	Amount transferred out this year	Addition for the year	Amortization for the year	Dec. 31, 2006
Merger Yichang Steelstrip addition of stock ownership investment difference	123,250,020.74	-	-	(43,500,007.32)	79,750,013.42
Merger Baosteel Chemical addition of stock ownership investment difference	243,372,066.85	-	-	(56,162,784.60)	187,209,282.25
Lease fee	25,037,818.30	-	2,022,648.46	(3,414,476.19)	23,645,990.57
The construction & management of East Range Mine	5,609,094.95	(5,609,094.95)	-	-	-
Others	17,599,635.64	-	4,833,063.25	(9,296,264.08)	13,136,434.81
Total	414,868,636.48	(5,609,094.95)	6,855,711.71	(112,373,532.19)	303,741,721.05

The Company

	Jan. 1, 2006	Addition for the year	Dec. 31, 2006
Merger Yichang Steelstrip Addition of stock ownership investment difference	123,250,020.74	(43,500,007.32)	79,750,013.42
Merger Baosteel Chemical addition of stock ownership investment difference	243,372,066.85	(56,162,784.60)	187,209,282.25
Total	366,622,087.59	(99,662,791.92)	266,959,295.67

## Notes to the Financial Statements (Continued)

31st December, 2006

## V. Explanatory Notes to Major Accounting Items (Continued)

## (16) Right of share untradable and circulation

At its shareholders meeting on June 2, 2006, Baosight Software deliberated on and passed untradable share reform plan, according to which, the Company, which is the principal non-tradable shareholder of Baosight Software, offered the following consideration to obtain the right of circulation of Baosight's shares: for every 10 tradable shares registered on the day of stock registration the holder of the tradable shares shall obtain 3.4 shares offered by the Company. For this non-tradable share reform, the Company had paid the holders of tradable shares a consideration worth 4,488,000 shares (i.e. 3.4 shares for every 10 shares) and these shares became tradable simultaneously. With the payment of the consideration, the Company owned 145,556,070 shares and its percentage of share ownership dropped from 57.22% to 55.50%.

In addition, the company makes the following commitment: the Company shall not trade or transfer its non-tradable shares of Baosight Software 24 months from the implementation of the untradable share reform on the first trading day; after the expiration of the period of commitment, it shall sell the shares through listing at Shanghai Stock Exchange and the percentage of shares sold and the total shares of the Company shall not exceed 5% within 12 months and 10% within 24 months. The Company shall not be restricted by the above commitment for any other means it takes to transfer its ownership of Baosight's shares. It shall not transfer its ownership of Baosight's shares until the assignee agrees to and has the capability of bearing the responsibilities stated in the above commitment. For any other things that are specifically prescribed by China Securities Regulatory Commission, the Company shall abide by the prescriptions.

In accordance with *Provisional Regulations on Accounting Treatment Relating to Reform of Non-tradable Shares* published by the Ministry of Finance on November 24, 2005, the right of circulation obtained by enterprises following the approved untradable share plan, by means of gift shares or decessing its legal person shares, and accounted by the equity method of the long-term investment, should debit "share-trading reform" in accordance with the book value of the long-term stock investment in correspondence with the shares given out or decreased. When crediting "long-term stock investment", effort should be made to credit relevant particulars. Therefore, The Company confirms its share-trading to be Rmb 7,949,489.18.

## (17) Deferred taxes debit /(credit)

The Group

	Jan. 1, 2006	Transferred-out of disposal of subsidiaries	Addition for the year	Reduction for the year	Foreign currency translation difference	Dec. 31, 2006
Provisions of losses of assets	336,969,223.57	-	67,483,236.04	(185,769,003.78)	-	218,683,455.83
Unrealized profit compensation in internal purchase and sales	178,942,174.55	-	150,761,437.46	-	-	329,703,612.01
Difference in residuals of fixed assets	34,717,655.23	-	13,927,911.10	(1,320,583.92)	(78,574.22)	47,246,408.19
Long-term investment-surplus	50,806,797.80	-	41,630,265.35	-	-	92,437,063.15
Others	58,863,395.92	(35,916.41)	9,805,138.10	(28,708,285.74)	(132,761.84)	39,791,570.03
Total	660,299,247.07	(35,916.41)	283,607,988.05	(215,797,873.44)	(211,336.06)	727,862,109.21
Tax allowance for investment income	(196,623,699.02)	-	-	52,586,605.31	-	(144,037,093.71)
Others	(9,858,684.01)	7,258,421.57	(722,541.68)	9,589.75	(148,708.65)	(3,461,923.02)
Total	(206,482,383.03)	7,258,421.57	(722,541.68)	52,596,195.06	(148,708.65)	(147,499,016.73)

The Company

	Jan. 1, 2006	Addition for the year	Reduction for the year	Dec. 31, 2006
Provisions of losses of assets	245,174,520.72	35,340,645.95	(171,637,748.64)	108,877,418.03
Difference in residuals of fixed assets	7,113,338.84	13,927,911.10	-	21,041,249.94
Long-term investment-surplus	57,318,973.18	50,738,157.92	-	108,057,131.10
Total	309,606,832.74	100,006,714.97	(171,637,748.64)	237,975,799.07
Tax allowance for investment income	(194,985,902.06)	-	50,948,808.35	(144,037,093.71)
Total	(194,985,902.06)	-	50,948,808.35	(144,037,093.71)

(Rmb)

## (18) Short-term loans

The Group

	Dec. 31, 2006	Dec. 31, 2005
Credit loan	19,712,593,264.44	9,388,943,980.44
Loans on mortgage	23,000,000.00	37,000,000.00
Guaranteed loan	21,411,510.00	23,000,000.00
Loans by Pledge (Note 5(3) and (5))	215,689,925.62	1,328,134,425.14
Non-interest bearing consignment loan of Baosteel (for holding the shares of Pacific Insurance Company)	937,500,000.00	937,500,000.00
For holding shares of Pacific Insurance Company on behalf of Baosteel Chemical (cost)	(937,500,000.00)	(937,500,000.00)
Total	19,972,694,700.06	10,777,078,405.58

At the balance sheet date, the Group's short-term loans from Baosteel Group Finance Co., Ltd was Rmb35,000,000.00 . (2005: Rmb 397,500,000.00).

At the balance sheet date, among the Group's short-term loans, annual interest rate ranges from 4.86% to 6.696% for short-term loans in Rmb (from 4.70% to 6.26% in 2005); and it ranges from LIBOR+0.34% to LIBOR+0.55% for short-term loans in U. S. Dollar (LIBOR+0.34% to LIBOR+0.35% in 2005). Annual rate in Yen (Japan) is 5.69% and it ranges from LIBOR+0.42% to LIBOR+0.55% in Euro. The foreign currency translation rate is Rmb 7.8087 (2005: 8.0702) v. one U. S. Dollar; Rmb 0.0656 v. 1 Yen (Japan) (2005: 0.0687); Rmb 10.2665 v. 1 Euro (2005: 9.5797).

As of December 31, 2006, the book value of the Group in fixed assets was Rmb 38,750,000.00 (2005: Rmb 61,028,000.00), which had been used as a pledge for a bank loan of Rmb 23,000,000.00 (2005: Rmb 37,000,000.00)

In November 2002, Baosteel Group entrusted Baosteel Chemistry with interest-free loan to invest in Pacific Insurance Company. As of December 31, 2006, this entrusted loan and relevant stock right of Pacific Insurance Company were going to be transferred.

Names of entrusted invested companies	Class of shares	Number of shares	Percentage of shareholding	Investment
Pacific Insurance Company (Group) Co., Ltd	legal person share	375,000,000	8.72%	937,500,000.00

The Company

	Dec. 31, 2006	Dec. 31, 2005
Credit loan	12,878,896,138.21	5,582,948,110.81
Loans on mortgage	5,103,802,821.50	-
Non-interest bearing consignment loan of Baosteel (for holding the shares of Pacific Insurance Company)	937,500,000.00	937,500,000.00
For holding shares of Pacific Insurance Company on behalf of Baosteel Chemical (cost)	(937,500,000.00)	(937,500,000.00)
Total	17,982,698,959.71	5,582,948,110.81

At the balance sheet date, among the Company's short-term loans, annual interest rate ranges from 5.22%/LIBOR+0.34% to 5.8325%/LIBOR+0.55% for short-term loans in U.S. dollars (from LIBOR+0.34% to LIBOR+0.35% in 2005). The foreign currency translation rate is Rmb 7.8087 (2005: 8.0702) v. 1 U. S. Dollar.

At the balance sheet date, the Company's short-term loans do not have borrowings from Baosteel Group Finance Co., Ltd. (2005: Rmb 350,000,000.00).

In November 2002, Baosteel Group entrusted Baosteel Chemistry with interest-free loan to invest in Pacific Insurance Company. As of 1st December 2005, with the merger of Baosteel Chemical, this entrusted loan and relevant stock right of Pacific Insurance Company was transferred into the accounting of our company.

Names of entrusted invested companies	Class of shares	Number of shares	Percentage of shareholding	Investment
Pacific Insurance Company (Group) Co., Ltd	legal person share	375,000,000	8.72%	937,500,000.00

## Notes to the Financial Statements (Continued)

31st December, 2006

## V. Explanatory Notes to Major Accounting Items (Continued)

## (19) Notes-payable

Notes-payable represent trade acceptances. Trade acceptances for the Group due to related companies totaled Rmb 167,347,194.82 versus Rmb 4,383,755,580.58 in 2005. Trade acceptances from the Company to related companies totaled Rmb 145,110,317.63 versus Rmb 1,140,742,403.06 in 2005. Among the notes-payable, no balance is due from a shareholder who holds 5% or more of the company's shares or voting power.

## (20) Trade payables

All the trade payables in the closing balance are less than three years old. Except for the trade payables of Baosteel Group Corporation, the holding company (see the table below), no balance is due from a shareholder who holds 5% or more of the Group's shares or voting power. Details of the trade payables due from related companies are as follows:

	The Group		The Company	
	Dec. 31, 2006	Dec. 31, 2005	Dec. 31, 2006	Dec. 31, 2005
Baosteel Group	128,754.57	235,776.42	41,000.00	-
Baosteel international and its subsidiaries	-	-	144,957,936.10	155,371,387.82
Baosight Software	-	-	39,988,898.41	35,216,410.20
Huangshi Coating & Galvanizing	-	-	15,960,430.85	57,761,274.95
Baosteel- NSC/Arcelor	43,120,839.76	71,747,426.66	86,241,679.51	132,806,259.11
Baodao Trading	-	-	715,170,734.94	93,762,727.35
Howa Trading	-	-	153,065,299.12	29,936,831.19
Meisteel	-	-	35,407,944.48	12,491,676.10
Baosteel Group Enterprise Development Corporation and its subsidiaries	239,455,421.40	171,959,696.23	228,668,795.71	163,582,227.82
Shanghai Baosteel Construction Technology Co., Ltd. and its subsidiaries	76,611,895.42	127,283,450.21	68,206,230.61	96,329,027.36
Baosteel Group Shanghai No. 5 Steel Co, Ltd. and its subsidiaries	67,488,525.96	18,295,690.15	67,488,525.96	16,859,017.88
Baosteel Group Shanghai Meishan Co., Ltd and its subsidiaries	323,801,774.30	192,660,335.19	2,913,521.76	11,510,434.35
Nantong Baosteel-NSC/Arcelor Automotive Steel Manufacturing Co., Ltd. and its subsidiaries	3,164,078.21	21,180,918.69	3,164,078.21	21,180,918.69
Baosteel Group Shanghai Pudong Steel Co., Ltd. and its subsidiaries	11,806,701.13	10,269,881.19	1,450,052.01	4,167,499.36
Baosteel Industrial Examination and its subsidiaries	20,744,842.26	26,614,412.08	19,612,497.54	26,565,004.23
Shanghai Baosteel Equipment Examination & Maintenance Co., Ltd. and its subsidiaries	78,764,856.28	79,179,850.95	76,752,393.78	79,017,378.45
Baosteel Group Shanghai First Steel Co., Ltd. and its subsidiaries	20,537,274.84	267,235,104.37	20,537,274.84	247,157,153.69
Lubao Industry & Trade	3,649,242.92	5,600,418.83	-	-
Shanghai Baosteel Technology and Economics Development and its subsidiaries	920,869.15	38,713,654.35	920,869.15	-
Shanghai Kebao Automobile Gearing Co Ltd	17,493,129.64	-	-	-
Others	9,735,544.69	12,765,785.12	15,434,839.82	13,878,385.25
Total	917,423,750.53	1,043,742,400.44	1,695,983,002.80	1,197,593,613.80

Amounts due to related companies are unsecured, non interest-bearing and payable on request.

(Rmb)

## (21) Receipts in advance

All the receipts in advance in the Closing Balance are one year old or less. Except for receipts in advance of Baosteel Group Corporation, the holding company (see the table below), no balance is due from a shareholder who holds 5% or more of the Company's shares or voting power. Details of receipts in advance due from related companies are as follows:

	The Group		The Company	
	Dec. 31, 2006	Dec. 31, 2005	Dec. 31, 2006	Dec. 31, 2005
Baosteel Group	433,690.84	1,655,079.51	-	-
Baosteel international and its subsidiaries	-	-	5,209,741,129.85	2,994,426,088.52
Yantai Lubao	-	-	22,970,003.13	14,487,375.64
Huangshi Coating & Galvanizing	-	-	54,320,632.91	46,890,994.17
Baosteel- NSC/Arcelor	1,109,263.69	19,668,791.68	92,166.37	39,192,583.36
Ningbo Baoxin	-	-	750,824,360.81	34,275,168.16
Meisteel	-	-	186,024,373.46	-
Baosteel Group Shanghai First Steel and its subsidiaries	98,094,028.08	50,739,706.14	97,591,170.93	50,030,497.32
Baosteel Group Shanghai Pudong Steel and its subsidiaries	127,999,860.42	244,601,316.87	114,336,391.10	233,385,023.69
Baosteel Group Enterprise Development Corporation and its subsidiaries	33,500,505.81	138,308,280.50	30,411,675.70	33,995,975.07
Baosteel Group Shanghai Plant No.2 Co., Ltd. and its subsidiaries	10,424,576.83	199,754,287.60	10,424,576.83	7,690,734.84
Lubao Sales Office	-	4,165,028.61	-	-
Shanghai Meishan Iron & Steel and its subsidiaries	7,371,518.05	71,692,012.46	-	460,527.44
Shanghai Baosteel Business Development Co., Ltd. and its subsidiaries	-	30,115,072.73	-	-
Shanghai Baosteel Technology and Economics Development and its subsidiaries	684,232.26	19,528,901.81	684,232.26	5,002,062.05
Baosteel Group Shanghai Steel Tube Co., Ltd. and its subsidiaries	3,881.80	8,448,184.94	-	1,876,569.91
Others	3,693,787.60	12,053,582.23	2,048,220.72	15,805,322.89
Total	283,315,345.38	800,730,245.08	6,479,468,934.07	3,477,518,923.06

Amounts due to related companies are unsecured, non interest-bearing and payable on request.

## Notes to the Financial Statements (Continued)

31st December, 2006

## V. Explanatory Notes to Major Accounting Items (Continued)

## (22) Dividends payable

	The Group		The Company	
	Dec. 31, 2006	Dec. 31, 2005	Dec. 31, 2006	Dec. 31, 2005
Dividends payable to Baosteel Group	517,633,725.92	566,857,652.17	-	-
Dividends payable to minority shareholders of the subsidiaries of Baosteel Intl.Trading	1,048,787.44	4,835,426.42	-	-
Dividends payable to minority shareholders of Shanghai Baosight Software	82,443.05	335,879.04	-	-
Dividends payable to minority shareholders of Yantai Lubao	-	2,999,257.82	-	-
Total	518,764,956.41	575,028,215.45	-	-

## (23) Taxes payable

	The Group		The Company	
	Dec. 31, 2006	Dec. 31, 2005	Dec. 31, 2006	Dec. 31, 2005
Value added tax	(19,993,281.38)	54,638,634.52	388,579,923.56	750,861,531.14
Business tax	9,083,294.39	6,959,265.90	2,934,917.72	2,437,055.16
Income tax	891,180,965.17	(590,645,152.60)	554,506,194.24	(739,465,451.48)
Property tax	46,589,593.26	37,958,233.27	39,086,045.23	37,626,613.33
City maintenance and construction tax	31,702,107.32	58,580,571.47	27,333,184.19	52,743,246.86
Personal income tax	59,016,737.61	66,224,382.63	36,546,539.70	41,061,717.63
Others	55,925,169.82	23,981,102.29	80,375.47	26,873.59
Total	1,073,504,586.19	(342,302,962.52)	1,049,067,180.11	145,291,586.23

Refer to Note 3 of the Notes to the Financial Statements for the rate of each taxable item.

## (24) Other Payables

	The Group		The Company	
	Dec. 31, 2006	Dec. 31, 2005	Dec. 31, 2006	Dec. 31, 2005
Education surcharge	40,124,782.02	29,976,415.00	11,727,578.76	22,613,349.83
Mining fee	27,930,808.96	28,013,758.67	-	-
Riverway management fee	4,423,476.89	11,701,237.14	3,863,713.65	7,531,248.39
Others	7,366,017.71	2,972,194.25	47,752.00	10,348.00
Total	79,845,085.58	72,663,605.06	15,639,044.41	30,154,946.22

Refer to Note 3 of the Notes to the Financial Statements for the rates of other payables.

## (25) Other Payables

Except for the final payment of the Rmb 1,113,311.69 for the construction of the Steel Rod Primary Rolling Factory, none of the payables of the Group and the Company is aged over three years. No balance, except for the payable of Rmb 120,787,379.04 to Baosteel Group, is due from a shareholder who holds 5% or more of the Group's shares or voting power. Except for the payables of Rmb 87,419,529.04 to Baosteel Group, no balance is due from those who own 5% or more of the Company's shares or voting power.

As at the 31st December 2006, other payables of the Group mainly consist of staff welfare fees including pension insurance, loaning to Meisteel for salary payment, port construction fees, port dues, and contract performance guarantee, etc. As at the 31st December 2006, these mainly include the Rmb 157,078,064.91 payable to Shanghai Baosteel Intl. Trading for asset purchases, debts, advance equity transfer payment, staff welfare fees including pension insurance, port construction fee and port dues.

## (26) Accrued expenses

	The Group		The Company	
	Dec. 31, 2006	Dec. 31, 2005	Dec. 31, 2006	Dec. 31, 2005
Interest expenditures	322,096,632.59	48,935,479.24	315,394,544.09	32,741,022.22
Accrued expenditures of certificates of title to houses	-	20,000,000.00	-	-
Quality guarantees	-	29,074,389.50	-	-
Patent using expenditures	17,065,485.72	13,601,586.62	-	-
Storage maintenance fees	17,862,882.30	6,222,965.96	-	-
Others	28,162,142.08	46,659,560.94	-	-
Total	385,187,142.69	164,493,982.26	315,394,544.09	32,741,022.22

## (27) Other current assets/liabilities

The year 2005 saw the establishment of the Baosteel Group Integrated Cash Management Platform (The Platform), in which the Company and other subsidiaries of Baosteel Group are involved. Surplus cash of the members flows into The Platform daily and those with financing gaps overdraw from it, helping the Group as whole to utilize funds to their best advantage. The depositors enjoy an interest rate of agreement savings as publicized by the People's Bank of China, while the overdrawers from the Platform repay at a rate of 90 per cent of the Bank's prime interest rate for half-year period.

As at the 31st December 2006, the sum the Company overdraw from the platform totaled Rmb 184,886,182.38.

## Notes to the Financial Statements (Continued)

31st December, 2006

## V. Explanatory Notes to Major Accounting Items (Continued)

## (28) Long-term loans

The Group

Lender	Curry	Dec. 31, 2006		Duration	Annual interest	Dec. 31, 2005	
		Original	RMB			Original	RMB
ICBC	RMB		2,220,000,000.00	2 years	4.86%~5.022%		2,350,000,000.00
ICBC	USD	970,567.30	7,578,868.88	11 years	6.25%	2,130,021.00	17,189,695.47
ICBC	JPY	2,309,098,224.10	151,476,843.49	3-5 years	4.19%~4.79%	4,524,434,402.19	310,828,643.43
CCB	RMB		1,350,821,775.00	3-8 years	4.86%~5.3%		2,056,917,928.00
CCB	USD	61,938,763.78	483,661,224.72	2-10.5 years	LIBOR+1%~1.2%/6.35%	87,787,883.62	708,465,778.36
CCB	EURO	28,991,923.70	297,645,584.64	3 years	FIBOR+0.305%	34,888,374.45	334,220,160.82
BOC	RMB		1,000,000,000.00	2 years	5.022%		2,300,000,000.00
BOC	HKD	1,674,577.93	1,682,448.45	20 years	10.25%	-	-
BOComm	RMB		860,000,000.00	4 years	4.86%~5.022%		2,499,520,000.00
BOComm	JPY		-	-	-	600,781,369.85	41,273,680.11
Baosteel Group Finance	RMB		5,177,834,750.00	2-5 years	5.022%~6.48%/Central bank rate *90%		4,280,965,000.00
Baosteel Group Finance	USD	18,035,038.47	140,830,204.90	2-10 years	LIBOR+1%	18,031,167.84	145,515,130.70
SPDB	USD	-	-	-	-	1,317,771.08	10,634,676.17
SDB	RMB		100,148,500.00	2-5 years	4.860%	-	-
CMB	RMB		200,297,000.00	2 years	Central bank rate *90%		650,619,224.25
CEBCEB	RMB		200,297,000.00	5 years	4.860%		500,804,375.00
EIBC	RMB		3,000,000,000.00	3 years	4.05%		2,000,000,000.00
JBIC	USD	3,765,064.06	29,400,255.73	2-9 years	LIBOR	7,538,475.48	60,837,004.83
CCIB	USD	28,075,000.00	219,229,252.50	5-15 years	LIBOR+0.75%~0.8%	10,375,000.00	83,728,325.00
SMBC	JPY	8,760,000.00	574,918.80	3 years	2.125%	13,752,000.00	944,982.43
SMBC	USD	1,520,000.00	11,869,224.00	3 years	5.32%	1,900,000.00	15,333,380.00
BOC	USD		-	-	-	235,596.30	1,901,309.26
Finance Company of Mitsui & Co., Ltd	USD		-	-	-	23,136,750.00	186,718,199.85
Mitsui & Co., Ltd	USD		-	-	-	634,750.00	5,122,559.45
CCB	RMB		-	-	-		50,000,000.00
Total			15,453,347,851.11				18,611,540,053.13

Less: Long-term loans to mature in one year

	RMB		35,055,125.00				1,783,420,000.00
	USD	21,485,853.33	167,776,582.86			46,964,644.83	379,014,076.71
	JPY	1,434,799,218.25	94,122,978.48			2,843,486,200.13	195,347,581.82
	EURO	5,990,384.69	61,500,284.39			6,136,450.71	58,785,356.88
Sub-total			358,454,970.73				2,416,567,015.41
Balance of long-term amount			15,094,892,880.38				16,194,973,037.72

(Rmb)

Of the long-term loans, Yen 2,309,098,224.10 (equal to Rmb 151,476,843.49) is collateralized by a guarantee letter issued by the Shanghai branch of the Industrial & Commercial Bank of China; and Euro 28,991,923.70 (equal to Rmb 297,645,584.64) and USD 2,579,202.49 (equal to Rmb 20,140,218.48) are guaranteed by Baosteel Group Finance Company. USD 3,765,064.06 (equal to Rmb 29,400,255.73) is jointly guaranteed by Nisshin Steel Co., Ltd., Mitsui & Co., Ltd. and Hanwa Co., Ltd.

Of the loans on mortgage, Rmb 219,229,252.50 is secured by four cargo ships, with a book surplus of Rmb 378,245,619.30 as at the 31st December 2006. Two other loans of Rmb 35,055,125.00 and Rmb 1,682,448.45 are collateralized by equipments and buildings, with respective book surpluses of Rmb 70,090,000.00 and Rmb 2,883,489.00 as at the 31st December 2006.

The long-term loans other than the above are exclusively unsecured loans. The applicable foreign exchange rates are Rmb 7.8087 (2005: Rmb 8.0702) v. one U.S. Dollar; Rmb 0.0656 (2005: Rmb 0.0687) against one Japanese yen; and Rmb 10.2665 (2005: Rmb 9.5797) against one Euro.

At the balance sheet date, the outstanding balance of the Group and the Company's long-term loans included commercial lendings of Rmb 437,814,275.94 from the China Construction Bank and the Industrial & Commercial Bank of China as the overseas banks' back-to-back loans.

#### Credit facility lines of bank borrowings

By December 31, 2006, the credit lines of bank borrowing obtained by the Group and the use of the credit lines are as follows:

Lending banks	Date of expiration	Currency	Credit lines	Credit lines used	Credit lines unused
ICBC	Dec. 31, 2009	RMB	9,748,480,000.00	2,373,077,395.57	7,375,402,604.43
ICBC	Nov. 16, 2011	RMB	2,200,000,000.00	200,000,000.00	2,000,000,000.00
ICBC	Spet. 25, 2007	USD	800,000,000.00	352,242,472.42	447,757,527.58
Baosteel Group Finance	June 13, 2010	RMB	5,500,000,000.00	4,600,000,000.00	900,000,000.00
Baosteel Group Finance	Nov. 28, 2011	RMB	1,500,000,000.00	-	1,500,000,000.00
Baosteel Group Finance	Aug. 15, 2007	RMB	550,000,000.00	550,000,000.00	-
ICBC	Dec. 31, 2008	RMB	15,000,000,000.00	7,866,371,284.37	7,133,628,715.63
BOComm	Aug. 10, 2010	RMB	5,696,330,000.00	2,922,545,570.60	2,773,784,429.40
BOC	Dec. 7, 2007	RMB	14,720,000,000.00	4,061,670,561.40	10,658,329,438.60
CCB	Dec. 11, 2008	RMB	800,000,000.00	200,000,000.00	600,000,000.00
SDB	Aug. 11, 2011	RMB	400,000,000.00	100,000,000.00	300,000,000.00
CEB	Jan. 10, 2012	RMB	500,000,000.00	200,000,000.00	300,000,000.00
HSBC	July 5, 2007	USD	30,000,000.00	30,000,000.00	-
HSBC	Nov. 23, 2007	USD	100,000,000.00	100,000,000.00	-
Citibank	Nov. 1, 2007	USD	220,000,000.00	100,000,000.00	120,000,000.00
Fortis Bank (Singapore)	June, 30, 2007	USD	10,000,000.00	2,000,000.00	8,000,000.00
SCB	Jan. 19, 2007	EURO	20,000,000.00	9,000,000.00	11,000,000.00
BOC(HK)	Apr., 2015	HKD	3,080,000.00	1,404,360.00	1,675,640.00

## Notes to the Financial Statements (Continued)

31st December, 2006

## V. Explanatory Notes to Major Accounting Items (Continued)

## The Company

Lender	Curry	Dec. 31, 2006		Duration	Annual interest	Dec. 31, 2005	
		Original	RMB			Original	RMB
ICBC	RMB		2,220,000,000.00	2 years	4.86%~5.022%		2,350,000,000.00
CCB	RMB		800,000,000.00	8 years	4.86%~5.022 %		1,506,000,000.00
BOComm	RMB		860,000,000.00	4 years	4.86%~5.022 %		2,499,520,000.00
ICBC	USD	970,567.30	7,578,868.88	11 years	6.25%	2,130,021.00	17,189,695.47
ICBC	JPY	2,309,098,224.10	151,476,843.49	3-5 years	4.19%-4.79%	4,524,434,402.19	310,828,643.43
CCB	USD	1,608,635.19	12,561,349.60	10.5 years	6.35%	26,841,398.83	216,615,456.81
CCB	EURO	28,991,923.70	297,645,584.64	3 years	FIBOR+0.305%	34,888,374.45	334,220,160.82
BOComm	JPY	-	-	-	-	600,781,369.85	41,273,680.11
CMB	RMB	-	-	-	-		250,000,000.00
BOC	RMB		1,000,000,000.00	2 years	5.022%		2,300,000,000.00
EIBC	RMB		3,000,000,000.00	3 years	4.05%		2,000,000,000.00
Baosteel Group Finance	RMB		4,600,000,000.00	5 years	5.022%~5.67%		3,700,000,000.00
Total			12,949,262,646.61				15,525,647,636.64

Less: Long-term loans to mature in one year

	RMB	-					1,733,420,000.00
	USD	2,059,657.42	16,083,246.86			26,467,217.34	213,595,737.34
	JPY	1,429,807,218.25	93,795,353.52			2,838,494,200.15	195,004,551.55
	EURO	5,990,384.69	61,500,284.39			6,136,450.71	58,785,356.88
Sub-total			171,378,884.77				2,200,805,645.77
Balance of long-term amount			12,777,883,761.84				13,324,841,990.87

The long-term loans as specified above are mostly unsecured loans. The exceptions are: Yen 2,309,098,224.10 (equal to Rmb 151,476,843.49) which is collateralized by a guarantee letter issued by the Shanghai branch of the Industrial & Commercial Bank of China; and Euro 28,991,923.70 (equal to Rmb 297,645,584.64) and USD 2,579,202.49 (equal to Rmb 20,140,218.48) which are guaranteed by Baosteel Group Finance Company Ltd. Applicable foreign exchange rates are Rmb 7.8087 (2005: Rmb 8.0702) vs. one U.S. Dollar ; Rmb 0.0656 (2005: Rmb 0.0687) against one Japanese yen; and Rmb 10.2665 (2005: Rmb 9.5797) against one Euro.

## Credit facility lines of bank borrowings

By December 31, 2006, the credit lines of bank borrowing obtained by the Company and the use of the credit lines are as follows:

Lending banks	Date of expiration	Currency	Credit lines	Credit lines used	Credit lines unused
CCB	Dec. 31, 2009	RMB	9,748,480,000.00	2,373,077,395.57	7,375,402,604.43
CCB	Sept. 25, 2007	USD	800,000,000.00	352,242,472.42	447,757,527.58
Baosteel Group Finance	June. 13, 2010	RMB	5,500,000,000.00	4,600,000,000.00	900,000,000.00
ICBC	Dec. 31, 2008	RMB	15,000,000,000.00	7,866,371,284.37	7,133,628,715.63
BOComm	Aug. 10, 2010	RMB	5,696,330,000.00	2,922,545,570.60	2,773,784,429.40
BOC	Dec. 7, 2007	RMB	14,720,000,000.00	4,061,670,561.40	10,658,329,438.60
HSBC	July 5, 2007	USD	30,000,000.00	30,000,000.00	-
HSBC	Nov. 23, 2007	USD	100,000,000.00	100,000,000.00	-
Citibank	Nov. 1, 2007	USD	220,000,000.00	100,000,000.00	120,000,000.00

(Rmb)

## (29) Long-term amount due to Holding Company

## The Group

	Dec. 31, 2006	Dec. 31, 2005
Payment for acquisition of assets of Phase-3	2,400,000,000.00	5,000,000,000.00
Payment for acquisition of parts of assets in custody	600,000,000.00	1,200,000,000.00
Others: Borrowing from Bao-Trans Enterprises	11,218,602.02	11,594,293.81
Borrowings from Bao-Island Enterprises	-	118,696,501.60
Total	3,011,218,602.02	6,330,290,795.41
Less: amount due within one year		
Payment for acquisition of assets of Phase-3	800,000,000.00	2,600,000,000.00
Payment for acquisition of parts of assets in custody	600,000,000.00	600,000,000.00
	1,400,000,000.00	3,200,000,000.00
Balance of long-term amount due to holding company		
Payment for acquisition of assets of Phase-3	1,600,000,000.00	2,400,000,000.00
Payment for acquisition of parts of assets in custody	-	600,000,000.00
Others: Borrowing from Bao-Trans Enterprises	11,218,602.02	11,594,293.81
Borrowings from Bao-Island Enterprises	-	118,696,501.60
	1,611,218,602.02	3,130,290,795.41

## The Company

	Dec. 31, 2006	Dec. 31, 2005
Payment for acquisition of assets of Phase-3	2,400,000,000.00	5,000,000,000.00
Payment for acquisition of parts of assets in custody	600,000,000.00	1,200,000,000.00
Total	3,000,000,000.00	6,200,000,000.00
Less: amount due within one year		
Payment for acquisition of assets of Phase-3	800,000,000.00	2,600,000,000.00
Payment for acquisition of parts of assets in custody	600,000,000.00	600,000,000.00
	1,400,000,000.00	3,200,000,000.00
Balance of long-term amount due to holding company		
Payment for acquisition of assets of Phase-3	1,600,000,000.00	2,400,000,000.00
Payment for acquisition of parts of assets in custody	-	600,000,000.00
	1,600,000,000.00	3,000,000,000.00

The payment for the acquisition of assets for Phase-3 is unsecured and will be paid by installments to Baosteel Group, the parent company, from 2003 to 2009, in accordance with the *Agreement of the Acquisition of Assets for Baosteel Phase-3 Construction* as well as the *Supplementary Agreement of the Acquisition of Assets for Baosteel Phase-3 Construction*. As specified in the agreements, the Company shall pay Rmb 2,600mn each year; from 2003 to 2006, and Rmb 800mn each year; from 2007 to 2009. The installment payments from 2003 to 2005 are not interest bearing; interest on the payments from 2006 to 2009 totals Rmb 800mn, and is due and shall be paid in the last five working days of December each year from 2002 to 2009. By 31st December 2006, the Company had paid a total interest of Rmb 656,000,000.00, including Rmb 148,000,000.00 paid in 2006, Rmb 184mn paid in 2005, Rmb 152mn paid in 2004, Rmb 120mn paid in 2003, and Rmb 52mn paid in 2002.

The payment for the acquisition of parts of assets in custody is unsecured and is not interest-bearing. It shall be paid by installments to the holding company Baosteel Group from 2003 to 2007, as laid down in the *Agreement on Assets Acquisition* signed on the 29th October 2002. Based on this agreement, the Company shall pay Rmb 600mn each year from 2003 to 2007. The amount paid this year was Rmb 600mn.

Other long-term payments due to holding company include the long-term loans from Baosteel Transport and from Baosteel Group, which last more than one year. These loans are unsecured and are not interest-bearing.

## Notes to the Financial Statements (Continued)

31st December, 2006

## V. Explanatory Notes to Major Accounting Items (Continued)

## (30) Share capital

The registered and paid-up capital of the Company totals Rmb 17,512,000,000 with par value of Rmb 1 each. The share class and structure is as follows:

	Opening balance number of shares	Additions and deductions for the year				Closing balance number of shares
		New shares warrant	Strike	Expiration of time limit for share selling	Total	
1. Shares with conditional rights						
State-owned (Held by SNGC)	13,640,809,539	79,596,591	(5,542,559)	(938,346,130)	(864,292,098)	12,776,517,441
Sub-total	13,640,809,539	79,596,591	(5,542,559)	(938,346,130)	(864,292,098)	12,776,517,441
2. Shares without conditional rights						
Rmb Ordinary	3,871,190,461	(79,596,591)	5,542,559	938,346,130	864,292,098	4,735,482,559
Sub-total	3,871,190,461	(79,596,591)	5,542,559	938,346,130	864,292,098	4,735,482,559
3. Total outstanding shares	17,512,000,000	-	-	-	-	17,512,000,000

As of December 31, 2006, Baosteel Group held 938,346,130 RMB ordinary shares that are without conditional rights.

In accordance with the reform program reviewed and approved on the 2005 First Interim Shareholders' Meeting held on 12th August 2005, the Baosteel Group, the only non-tradable shareholder of the Company, shall make tradable its shares in the consideration of a payment of 2.2 shares for every ten tradable shares the holders have registered on the day of registration and a European style warrant of subscription right with an expiry period of 378 days till 18th August 2006 and an exercise price of 4.50. The non-tradable share of the Group shall circulate on market when credits are made to the accounts of the shareholders. After the implement of the program, the total capital stock of the Company is still 17,512,000,000 and financial indexes such company assets, debts, owners' rights and interests, and income-per-share remain what they are.

Baosteel Group has made the following promises for the above purpose: The Group shall not sell the new shares and is obliged to disclose the related information within the six months after the implementation of the increase program; within the twelve months since it is entitled the right to trade its shares, the Group shall not sell or transfer the Company's shares, and only twenty-four months after the entitlement the Group's shares shall be listed on the market; the total sales of the Company's shares the Group has conducted in stock exchanges within the thirty-six months since it is entitled circulating right of its shares shall not be more than five per cent of the total share of the Company and the price shall not be less than 5.63 per share; and within the three years since the entitlement, the shares of the Company that the Group own shall not be less than 67 per cent of the total of the Company. However, new shares of the Company that the Group has acquired after the reform program shall be out of the province of the above limitations in regard of trading and transferring.

Baosteel Group has also promised that, if the A shares of the Company fall at a level below 4.53 per share, the Group shall inject no more than Rmb 2 billion in the aggregation to purchase the general public shares of the Company by means of competitive pricing at the Stock Exchange of Shanghai. The Group shall not sell the newly owned shares and is obliged to disclose the related information within the six months after the promotion program. Up to 21st September 2005 the Group had fulfilled the promise of Rmb 2 billion injection, with its holding of the Company amounting to 446,565,849 shares.

In order to further the non-tradable share reform program so as to prevent the Company's shares from irrational fluctuating and protect the interests of the investors, Baosteel Group made further efforts by promising that, in case that the shares of the Company drop to a level below 4.53 per share six months after the above-mentioned two-month period, the Group shall inject another sum of no more than Rmb 2 billion in the aggregation, together with the remaining of the first injection if it has not being used up, to purchase the Company's shares by means of competitive pricing at the Stock Exchange of Shanghai until the promised sum has been used up or the Company's shares rise at a level above 4.53 per share. The commitment shall be fulfilled on the condition that the China Securities Regulatory Commission exempts the Group from the duties of compulsive acquisition offer of the company's stocks and that the non-tradable share reform program is approved by the Company's Shareholders' General Meeting. The Group shall not sell the newly purchased shares and is obliged to disclose the related information within the six months after the supporting program. The document No. [2005]95 issued by the China Securities Regulatory Commission has agreed to exempt the Group from the duties in the purchase referred to.

By the end of 2005, Baosteel Group further increased 412,183,690 shares. During January 1-5, 2006, the Group increased its shares of the Company by 79,596,591. Up to 5th January 2006 the Group had fulfilled the promise of the second Rmb 2-billion injections, with its holding of the Company's shares amounting to 491,780,281.

On April 15, 2006, the six-month duration as the time limit for share selling for the 446,565,849 shares of the Company owned by Baosteel Group with a first injection of Rmb 2 billion expired and the shares could be traded on the stock market. On August 31, 2006, the European warrant was expired and some shareholders with tradable shares purchased 5,542,559 shares of the Company from Baosteel Group. On October 16, 2006, the six-month duration as the time limit for share selling for the 491,780,281 shares of the Company owned by Baosteel Group with a second injection of Rmb 2 billion expired and the shares could be traded on the stock market.

(Rmb)

## (31) Capital reserves

## The Group

	Jan. 1, 2006	Addition for the year	Deduction for the year	Dec. 31, 2006
Reserve from conversion of state-owned share	5,726,556,609.73	-	-	5,726,556,609.73
Share premium	26,236,613,490.51	-	-	26,236,613,490.51
Reserve for donated non-cash assets	819,271.03	369,068.33	-	1,188,339.36
Transfers from appropriation	523,813,624.69	90,211,993.99	-	614,025,618.68
Reserve from proportionate consideration for jointly-controlled entities	65,965,316.18	-	-	65,965,316.18
Reserve for equity investment	132,947,545.81	(2,059,268.93)	(96,859,618.35)	34,028,658.53
Other capital reserves	36,255,567.17	89,306,632.71	-	125,562,199.88
Total	32,722,971,425.12	177,828,426.10	(96,859,618.35)	32,803,940,232.87

## The Company

	Jan. 1, 2006	Addition for the year	Deduction for the year	Dec. 31, 2006
Reserve from conversion of state-owned share	5,726,556,609.73	-	-	5,726,556,609.73
Share premium	26,236,613,490.51	-	-	26,236,613,490.51
Reserve for donated non-cash assets	246,252.55	133,999.87	-	380,252.42
Transfers from appropriation	523,813,624.69	88,852,917.19	-	612,666,541.88
Reserve for equity investment	218,380,549.00	30,519,359.85	(13,647,793.00)	235,252,115.85
Other capital reserves	23,491,146.63	1,004,414.40	-	24,495,561.03
Total	32,729,101,673.11	120,510,691.31	(13,647,793.00)	32,835,964,571.42

- (i) The transfers from the annual appropriation for the Group and the Company are mainly contributed to by the refund from the funding of the port construction in accordance with the relevant regulations of the Ministry of Transport and the Ministry of Finance on collection of port construction fee.
- (ii) The reserve from proportionate consolidation for the jointly-controlled entities of the Group early this year is mainly derived from the investment in Bao-NSC/Arcelor Auto Sheet by the Company with a non-cash assets injection. Because the value increase from assets evaluation is accounted as the reserve-for-equity investment of the Company, the unamortized portion of reserve-for-equity investment when consolidating Bao-NSC/Arcelor Auto Sheet, has been transferred to the reserve from the section titled "Proportionate consideration for jointly-controlled entities" within the consolidated financial statements.
- (iii) The reserve for equity investment of the Group early this year is mainly for the equity investment credit difference incurred from acquisition of subsidiaries and joint ownership enterprises. Change in this year's reserve for equity investment is mainly due to the change in the accounting of the capital reserve of joint ownership companies by the equity method and the other changes in capital reserve is mainly due to the transfer of the reserve for equity investment caused by the disposal of joint ownership companies.
- (iv) The reserve for equity investment of the Group early this year is mainly for the equity investment credit difference incurred from investment in Baosteel-NSC/Arcelor Auto Steel Sheets Co., Ltd and acquisition of subsidiaries. Increase of the reserve for equity investment for this year is mainly due to the increase of the Company's capital reserve by the equity method.

## Notes to the Financial Statements (Continued)

31st December, 2006

## V. Explanatory Notes to Major Accounting Items (Continued)

## (32) Earnings reserves

The Group

	Jan. 1, 2006	Addition for this year	Dec. 31, 2006
Statutory earnings reserve	4,169,545,751.19	1,650,867,940.40	5,820,413,691.59
Public welfare fund	4,157,679,368.40	(4,157,679,368.40)	-
Reserve fund	19,559,023.05	5,637,713.53	25,196,736.58
Enterprise development fund	23,843,659.75	5,203,833.80	29,047,493.55
Discretionary earnings reserves	3,326,451,985.77	5,557,466,776.03	8,883,918,761.80
Total	11,697,079,788.16	3,061,496,895.36	14,758,576,683.52

The Company

	Jan. 1, 2006	Addition for this year	Dec. 31, 2006
Statutory earnings reserve	3,934,071,397.94	1,333,884,675.27	5,267,956,073.21
Public welfare fund	3,934,071,397.94	(3,934,071,397.94)	-
Discretionary earnings reserves	3,271,452,339.78	5,267,956,073.21	8,539,408,412.99
Total	11,139,595,135.66	2,667,769,350.54	13,807,364,486.20

According to the *Company Law* of China and the *Charter of the Company*, the Company will allocate 10% of its net profit as a statutory earnings reserve until the reserve has accumulated to reach 50% of the Company's registered capital. In compliance with the Company Law and the Company's Charter, parts of the statutory earnings reserves can be converted into the Company's share capital. If the shareholders' general meeting approves a conversion of the earnings reserve into share capital, existing shareholders are entitled to receive new shares or proportionate increases in face value. The remaining balance of the statutory earnings reserve shall not be lower than 25% of registered capital.

According to the *Company Law* of China and *Notice of the Ministry of Finance on the Relevant Enterprise Accounting Treatment after the Effect of the Company Law*, the Company stopped provision of public welfare funds in 2006 and the balance of the public welfare fund having been withdrawn by the Company up to December 31, 2006 shall be used as discretionary earnings reserves.

(Rmb)

**(33) Retained earnings**

## The Group

	Dec. 31, 2006	Dec. 31, 2005
Opening balance of retained earnings	12,591,395,511.37	9,966,453,299.90
Addition of the year	13,010,264,517.47	12,665,528,991.45
Less: Profit distributed of the year		
- Statutory earnings reserve	1,650,867,940.40	1,529,679,670.20
- Public welfare fund	-	1,517,813,287.41
- Reserve fund	5,637,713.53	17,594,904.97
- Enterprise development fund	5,203,833.80	22,453,954.46
- Discretionary earnings reserve	1,399,787,407.63	1,349,204,962.94
- Dividends ordinary shares	5,603,840,000.00	5,603,840,000.00
End balance of retained earnings	16,936,323,133.48	12,591,395,511.37

## The Company

	Dec. 31, 2006	Dec. 31, 2005
Opening balance of retained earnings	13,680,726,945.49	10,151,244,293.06
Addition of the year	13,338,846,752.65	13,047,603,789.19
Less: Profit distributed of the year		
- Statutory earnings reserve	1,333,884,675.27	1,304,760,378.92
- Public welfare fund	-	1,304,760,378.92
- Discretionary earnings reserve	1,333,884,675.27	1,304,760,378.92
- Dividends ordinary shares	5,603,840,000.00	5,603,840,000.00
End balance of retained earnings	18,747,964,347.60	13,680,726,945.49

**(34) Dividend payout proposed by Board of Directors**

According to the resolution passed at the 5th Meeting of the Third Board of Directors on March 29 2007, cash dividends of Rmb 3.5 (including tax) per ten shares; or a total amount of Rmb 6,129,200,000.00, were proposed by the Directors. The resolution is subject to final approval by shareholders in the forthcoming 2006 Annual Shareholders' General Meeting.

## Notes to the Financial Statements (Continued)

31st December, 2006

## V. Explanatory Notes to Major Accounting Items (Continued)

## (35) Revenue from principal operations

	The Group		The Company	
	2006	2005	2006	2005
Steel products	114,905,419,550.27	96,664,942,677.43	97,884,020,688.47	87,498,354,891.41
Trade	30,152,900,519.13	20,897,934,907.02	5,291,780,266.48	491,907,870.51
Others	12,733,145,537.20	9,045,483,962.28	14,428,111,292.46	10,555,638,711.99
Total	157,791,465,606.60	126,608,361,546.73	117,603,912,247.41	98,545,901,473.91

The total sales to the five largest customers of the Group and the Company reached, respectively, Rmb 16,993,335,076.39 (2005: Rmb 31,629,694,395.70) and Rmb 83,878,702,857.74 (2005: Rmb 75,362,574,053.85), accounting for 10.77% (2005: 24.98%) and 71.32% (2005: 76.47%) of the total sales revenues of the Group and the Company respectively.

## (36) Cost of sales for principal operations

	The Group		The Company	
	2006	2005	2006	2005
Steel products	89,221,236,934.80	72,382,879,092.54	78,245,273,263.27	65,150,030,655.08
Trade	29,289,663,409.88	20,445,443,188.90	5,057,089,111.18	475,918,541.59
Others	10,718,002,343.54	7,153,334,566.30	12,937,644,904.42	9,820,093,426.13
Total	129,228,902,688.22	99,981,656,847.74	96,240,007,278.87	75,446,042,622.80

## (37) Taxes and surcharges for principal operations

	The Group		The Company	
	2006	2005	2006	2005
Sales tax	27,543,663.24	19,847,883.40	3,864,221.80	3,622,871.61
City construction tax	440,761,639.92	469,339,254.17	367,563,014.06	411,507,971.82
Educational surcharge	192,230,185.77	202,405,874.93	157,530,295.03	176,363,299.86
Others	8,950,849.94	3,648,063.48	2,350,822.05	-
Total	669,486,338.87	695,241,075.98	531,308,352.94	591,494,143.29

Refer to Note 3 for the relevant criteria and tax rates for the above items.

(Rmb)

**(38) Operating information by business**

Details of sales revenues, costs of goods sold and gross margins of the businesses accounting for over 10% of total revenues from the principal businesses:

**The Group**

	Sales Revenues		Costs of Goods Sold		Gross Margin	
	2006	2005	2006	2005	2006	2005
	(Rmb '000)	(Rmb '000)	(Rmb '000)	(Rmb '000)	(Rmb '000)	(Rmb '000)
Iron & steel	114,905,420	96,664,943	89,221,237	72,382,879	25,684,183	24,282,064
Trade	30,152,900	20,897,935	29,289,663	20,445,443	863,237	452,492
Others	12,733,146	9,045,484	10,718,002	7,153,335	2,015,144	1,892,149
Total	157,791,466	126,608,362	129,228,902	99,981,657	28,562,564	26,626,705

**The Company**

	Sales Revenues		Costs of Goods Sold		Gross Margin	
	2006	2005	2006	2005	2006	2005
	(Rmb '000)	(Rmb '000)	(Rmb '000)	(Rmb '000)	(Rmb '000)	(Rmb '000)
Iron & steel	97,884,021	87,498,355	78,245,273	65,150,031	19,638,748	22,348,324
Trade	5,291,780	491,908	5,057,089	475,919	234,691	15,989
Others	14,428,111	10,555,638	12,937,645	9,820,093	1,490,466	735,545
Total	117,603,912	98,545,901	96,240,007	75,446,043	21,363,905	23,099,858

**(39) Administrative expense**

The steel & iron market improved at the end of 2006 compared with the end of 2005, which made the provision decline in value of inventory less than that at the end of 2005. Therefore, this year's administrative expense of the Group decreased by Rmb 648,504,174.97 incurred from the provision decline in value of inventory as against an increase of Rmb 490,104,069.03 in 2005.

**(40) Financial expenses**

	The Group		The Company	
	2006	2005	2006	2005
Interest expenses	1,724,260,342.02	1,262,643,028.60	1,383,068,079.36	906,066,228.42
Less: Interest income	91,173,080.67	64,246,489.24	125,819,326.85	54,406,369.33
Foreign exchange translation losses/gains	(382,570,957.20)	(191,689,448.69)	(373,337,868.53)	(105,500,146.02)
Others	55,849,042.65	36,901,757.60	15,655,848.94	7,858,835.41
Total	1,306,365,346.80	1,043,608,848.27	899,566,732.92	754,018,548.48

## Notes to the Financial Statements (Continued)

31st December, 2006

## V. Explanatory Notes to Major Accounting Items (Continued)

## (41) Investment income

	The Group		The Company	
	2006	2005	2006	2005
Investment income government & corporate bonds	-	18,310,301.80	-	18,250,301.80
income from stock investment	96,439,461.10	-	18,200.00	-
Proportionate recognition of profits from subsidiaries	-	-	2,581,235,140.56	1,350,198,217.34
Proportionate recognition of profits from un-consolidated subs	101,531,554.65	70,392,083.59	-	-
Proportionate recognition of profits/losses from joint-ventures	(6,100,237.80)	792,837.41	271,925,072.51	(244,805,504.81)
Proportionate recognition of profits/losses from joint ownership companies	307,049,002.35	193,273,870.08	62,624,947.80	21,079,386.29
Return from other equity investment	101,645,292.41	25,609,814.24	22,705,515.00	-
Amortization of difference in equity investment	(131,359,235.35)	(167,225,040.38)	(153,751,993.70)	(172,433,967.21)
Redemption of mutual funds	-	24,412,774.45	-	23,443,386.45
Losses from equity transfer	(144,587,196.76)	6,051,716.42	(198,859.72)	-
Income from creditor investment	-	11,437,261.21	-	-
Short-term investment losses /provision	-	(3,260,787.77)	-	2,578,247.32
Long-term investment losses	-	464,544.50	-	-
Others	748,679.77	1,097,075.10	21,188.97	14,402.63
Total	325,367,320.37	181,356,450.65	2,784,579,211.42	998,324,469.81

## VI. Related Party Transactions

### 1. Related parties with controlling relationships

Name	Place of registration	Principal business	Relationship with the Company	Company Type	Legal representative
Baosteel Group	Shanghai	Production, processing, sales and R&D of steel products	Holding company	State-owned	Xie Qihua
Yantai Lubao	Yantai	Production and sales of steel tubes	Controlled subsidiary	Limited company	Liu Yuwen
Huangshi Coating & Galvanizing	Huangshi	Production and sales of zinc galvanized sheets	Subsidiary	Limited company	Yu Xuewen
Baosteel Intl.Trading	Shanghai	Steel and iron trade	Controlled subsidiary	Limited company	He Wenbo
Meisteel	Nanjing	Production and sales of steel materials	Controlled subsidiary	Limited company (non-listed)	Li Yongxiang
Ningbo Baoxin	Ningbo	Processing and sales of cold-rolled stainless steel sheets	Controlled subsidiary	Limited company	Dai Zhihao
Baosight Software	Shanghai	Software development	Controlled subsidiary	Limited company	Wang Wenhai
Baosteel Trading Co., Ltd. (America)	Texas, America	Steel and iron trading	Controlled subsidiary	Limited company	Wang Jing
Howa Trading Corporation	Tokyo	Steel and iron trading	Controlled subsidiary	Limited company	Zhao Fanglin
Baosteel Hong Kong Trading Company	Hong Kong, China	Steel and iron trading	Controlled subsidiary	Limited company	Zhang Dianbo
Baosteel Europe	Hamburger, Germany	Steel and iron trading	Controlled subsidiary	Limited company	Ye Meng
Baosteel Singapore PET Ltd.	Singapore	Steel and iron trading	Controlled subsidiary	Limited company	Qiu Chengzhi
Bao-Trans Enterprises Ltd.	Hong Kong, China	Steel and iron trading	Controlled subsidiary	Limited company	Chen Min
Baosteel Trading (Brazil) Co., Ltd.	Rio de Janeiro	Sales of iron ore	Controlled subsidiary	Limited company	Zhao Yonghong
Suzhou Baohua	Suzhou	Production and sales of carbon black	Controlled subsidiary	Limited company	Hui Wenming
Special Metals	Shanghai	Steel and iron trading	Controlled subsidiary	Limited company	Wang Lirong
Shanghai No.5 Steel Gas Co., Ltd.	Shanghai	Gas supply and testing; installation and maintenance of gas-generation equipment	Controlled subsidiary	Limited company	Jiang Lanneng
Shanghai No.5 Steel Pudong Intl.Trade	Shanghai	Sales of rolled steel	Controlled subsidiary	Limited company	Zhao Qunbao
Dongguan Baoste Die Steel Co., Ltd	Dongguan	Processing and sales of steel	Controlled subsidiary	Limited company	Zhou Longyun
Anhui Wanbao Mining Co., Ltd.	Chizhou	Non-metal products and mining machinery	Controlled subsidiary	Limited company (Non-listed)	Zhang Dianbo
Bsteel Online	Shanghai	E-commerce	Controlled subsidiary	Limited company	Dai Zhihao
Yantai Lubao Industry & Trade	Yantai	Sales of steel tubes	Controlled sub-subsiary	Limited company	Ju Xinhua
Lubao Sales Office	Shanghai	Sales of steel tubes	Controlled sub-subsiary	State-owned	Lin Zhimin
Shanghai Baosteel Pudong International Trade	Shanghai	Steel & iron trading	Controlled sub-subsiary	Limited company	Huang Xingrong
Guangzhou Baosteel Southern Trade	Guangzhou	Steel & iron trading	Controlled sub-subsiary	Limited company	Huang Xingrong
Baosteel Jingchang	Guangzhou	Steel product processing and delivery	Controlled sub-subsiary	Limited company	Zhou Longyun
Baosteel Guangzhou International Trade	Guangzhou	Steel & iron trading	Controlled sub-subsiary	Limited company	Zhou Longyun
Tianjin Baosteel Northern Trade	Tianjin	Steel & iron trading	Controlled sub-subsiary	Limited company	Huang Xingrong
Chengdu Baosteel Western Trade	Chengdu	Steel & iron trading	Controlled sub-subsiary	Limited company	Huang Xingrong
Shanghai Baosteel Steel Products Trade	Shanghai	Steel & iron trading	Controlled sub-subsiary	Limited company	Huang Xingrong
Hangzhou Steel Delivery	Hangzhou	Steel product processing and delivery	Controlled sub-subsiary	Limited company	Ma Su
Shanghai Baosteel Enterprise	Shanghai	Retrieving, processing and sale of steel scrap	Controlled sub-subsiary	Limited company	Zhang Dianbo
Shanghai Xinran Metal	Shanghai	Retrieving, processing and sale of steel scrap	Controlled sub-subsiary	Limited company	Guan Shurong
Shanghai Baosteel Automobile Trading	Shanghai	Car trading	Controlled sub-subsiary	Limited company	Jia Yanlin
Shanghai Baosteel Commerce & Trade	Shanghai	Steel & iron trading	Controlled sub-subsiary	Limited company	Huang Xingrong
Baosteel Cargo Agency	Shanghai	Forwarding agent	Controlled sub-subsiary	Limited company	Li Jianwei
Chongqing Baomit Steel Materials Processing & Delivery	Chongqing	Steel product processing and delivery	Controlled sub-subsiary	Limited company	Song Bin
Shanghai Petrol-China Baoshun Petrol-Chemical	Shanghai	Petroleum and chemical products trading	Controlled sub-subsiary	Limited company	Li Ruoping
Shenyang Steel Materials Delivery	Shenyang	Steel product processing and delivery	Controlled sub-subsiary	Limited company	Zou Changzheng
Rizhao Baoxin	Rizhao	Ore mining and processing	Controlled sub-subsiary	Limited company	Wang Shiyu
Shanghai Shenjing	Shanghai	Steel products processing and sale	Controlled sub-subsiary	Limited company	Zou Changzheng
Xinhua Steel	Shanghai	Old and disused ship dismembering	Controlled sub-subsiary	Limited company	Xia Xiaoming

## Notes to the Financial Statements (Continued)

31st December, 2006

## VI. Related Party Transactions (Continued)

Name	Place of registration	Principal business	Relationship with the Company	Company Type	Legal representative
Shanghai Baosheng Energy	Shanghai	Coal trading	Controlled sub-subsidiary	Limited company	Zhou Zhuping
Qingdao Baohan Transport & Trading	Qingdao	Cargo delivery	Controlled sub-subsidiary	Limited company	Zhang Dianbo
Changchun Faw Baoyou	Changchun	Steel product processing and delivery	Controlled sub-subsidiary	Limited company	Huang Xingrong
Baosteel Trasport	Shanghai	Cargo delivery	Controlled sub-subsidiary	Limited company	Zhang Dianbo
Baosteel Steel Resources	Shanghai	Old and disused vehicles dismembering	Controlled sub-subsidiary	Limited company	Xia Xiaoming
Shanghai Baomit	Shanghai	Steel product processing and delivery	Controlled sub-subsidiary	Limited company	Huang Xingrong
Qingdao Baomit	Qingdao	Steel product processing and delivery	Controlled sub-subsidiary	Limited company	Zhang Wei
Fuzhou Baomit	Fuzhou	Processing and delivery of steel materials	Controlled sub-subsidiary	Limited company	Zhou Longyun
Baoding Energy	Shanghai	Sales of coal and steel products	Controlled sub-subsidiary	Limited company	Zhou zhuping
Packing Steel Strap	Shanghai	Production and sales of packaging materials	Controlled sub-subsidiary	Limited company	Guan Shurong
Foshan Distribution	Foshan	Processing and delivery of steel materials	Controlled sub-subsidiary	Limited company	Zhang Yong
Anhui Steel Materials Delivery	Hefei	Processing and delivery of steel materials	Controlled sub-subsidiary	Limited company	Shen Weiping
Baotong Transport	Shanghai	Freight	Controlled sub-subsidiary	Limited company	Li Jianwei
Baoyang Intl.	Shanghai	Transportation agency	Controlled sub-subsidiary	Limited company	Wang Jianming
Guangzhou Renhui	Guangzhou	Auto sales	Controlled sub-subsidiary	Limited company	Zhou Longyun
Wuxi Designated M & R Center	Wuxi	Car services	Controlled sub-subsidiary	Limited company	Cheng Xianru
Jiangxi Used Car	Nanchang	Auto sales	Controlled sub-subsidiary	Limited company	Cao Weiping
Baosteel Used Motor Vehicles Trading Co., Ltd.	Shanghai	Auto sales	Controlled sub-subsidiary	Limited company	Fang Shu
Jiaxing Baoda	Jiaxing	Auto sales	Controlled sub-subsidiary	Limited company	Fang Shu
Shanghai Baole	Shanghai	Auto sales	Controlled sub-subsidiary	Limited company	Xu Xiancheng
Shanghai Baoyou	Shanghai	Auto sales	Controlled sub-subsidiary	Limited company	Fang Shu
Wuhan Baosteel Central Trading	Wuhan	Steel trade, processing and delivery of steel products	Controlled sub-subsidiary	Limited company	Huang Xingrong
Baoshan Steel Materials	Shanghai	Sales and processing of steel materials	Controlled sub-subsidiary	Limited company	Zhang Yong
Guangzhou Huajing	Guangzhou	Processing and sales of auto spare parts	Controlled sub-subsidiary	Limited company	Zhou Longyun
Shengsi Baojie	Zhoushan	Shipping agency	Controlled sub-subsidiary	Limited company	Wang Jianming
Chongqing Baosteel	Chongqing	Metal material processing and sales	Controlled sub-subsidiary	Limited company	Zou Changzheng
Shanghai Stainless Steel	Shanghai	Metal material processing and sales	Controlled sub-subsidiary	Limited company	Zou Changzheng
Nanchang Delivery	Nanchang	Car components processing and sales	Controlled sub-subsidiary	Limited company	Fu Jianguo
Tianjin Delivery	Tianjin	Car components processing and sales	Controlled sub-subsidiary	Limited company	Zou Changzheng
Guangzhou Delivery	Guangzhou	Processing and stocking steel products and metals	Controlled sub-subsidiary	Limited company	Zhou Longyun
Nanjing Delivery	Nanjing	Car components and metal material processing	Controlled sub-subsidiary	Limited company	Zou Changzheng
Yantai Baomit	Yantai	Processing and stocking steel products and metals	Controlled sub-subsidiary	Limited company	Zhang Wei
Finance Co., Ltd.	Shanghai	Financial and foreign currency businesses	Controlled sub-subsidiary	Limited company	Yu Yeming
Yishiqi Energy	Nanjing	Production and sales of electricity and steam	Controlled sub-subsidiary	Limited company	Shen Jianguo
Tiemei Transport	Nanjing	Sales of metal products and transportation services	Controlled sub-subsidiary	Limited company	Liu Jianchao
Baoxin Industrial	Ningbo	Wood, paper rolls, and packaging of stainless steel products	Controlled sub-subsidiary	Limited company	Pan Shihua
Baoxi Computer	Shanghai	Software development and technical support	Controlled sub-subsidiary	Limited company	Zhu Liqiang
Baojing Information	Shanghai	Software development and technical support	Controlled sub-subsidiary	Limited company	Zhou Jianping
Baoli Integration	Shanghai	Software development and technical support	Controlled sub-subsidiary	Limited company	Wang Li
Baokang Electronic	Shanghai	Software development and technical support	Controlled sub-subsidiary	Limited company	Feng Guocheng
Japan Baosight	Tokyo	Software development and technical support	Controlled sub-subsidiary	Limited company	Li Yongjun
Baoli Automation	Shanghai	Auto-control system development, manufacturing and sale	Controlled sub-subsidiary	Limited company	Zhu Liqiang
Meishan Design Institute	Shanghai	Metallurgical engineering design, construction engineering design	Controlled sub-subsidiary	Limited company	Chen Zaigen
Guichi Gangbu	Chizhou	Port loading- unloading operation, stacking and warehouse	Controlled sub-subsidiary	Limited company	Fu Yan
Baosight Technology	Hong Kong, China	Trading company	Controlled sub-subsidiary	Limited company	Zhou Jianping
Bao-Australia PTY	Perth	Steel trading	Controlled sub-subsidiary	Limited company	Jin Lei
Italy Steel Materials	Genoa, Italy	Steel trading	Controlled sub-subsidiary	Limited company	Ye Meng

As the controlling parent company, Baosteel Group holds 50 per cent of the share capital of the Company.

All companies with which Baosteel Group has controlling relationships are classified as the Company's jointly-controlled affiliates, subsidiaries or jointly-controlled entities.

(Rmb)

## 2. Capital and changes of capital, of related parties with controlling relationships

Name	Currency	Beginning of year	Increase of the year	Decrease of the year	End of year
Baosteel Group	Rmb	45,800,000,000.00	-	-	45,800,000,000.00
Lubao Steel Tubes	Rmb	100,000,000.00	-	-	100,000,000.00
Huangshi Coating	USD	8,000,000.00	-	-	8,000,000.00
Baosteel Intl.Trading	Rmb	2,248,878,553.55	-	-	2,248,878,553.55
Meisteel	Rmb	6,256,570,000.00	-	-	6,256,570,000.00
Ningbo Baoxin	Rmb	2,848,380,000.00	-	-	2,848,380,000.00
Baosight Software	Rmb	262,244,070.00	-	-	262,244,070.00
Baosteel (America)	USD	980,000.00	-	-	980,000.00
Howa Trading	Yen	876,000,000.00	-	-	876,000,000.00
Baosteel Hong Kong Trading Company	HKD	62,410,000.00	-	-	62,410,000.00
Baosteel Europe	EURO	2,050,000.00	-	-	2,050,000.00
Baosteel Singapore	SingD	1,500,000.00	-	-	1,500,000.00
Bao-Trans Enterprises	HKD	1,000,000.00	-	-	1,000,000.00
Boasteel Brazil	USD	980,000.00	-	-	980,000.00
Suzhou Baohua	Rmb	220,000,000.00	75,000,000.00	-	295,000,000.00
Special Metal	Rmb	-	50,000,000.00	-	50,000,000.00
Shanghai No. 5 Steel Gas	Rmb	127,718,247.00	-	-	127,718,247.00
Shanghai No. 5 Steel Pudong Intl.Trade	Rmb	17,400,000.00	-	-	17,400,000.00
Dongguan Baoste Die Steel	Rmb	30,000,000.00	-	-	30,000,000.00
Anhui Wanbao Mining	Rmb	32,000,000.00	-	-	32,000,000.00
Bsteel Online	Rmb	80,000,000.00	-	-	80,000,000.00
Yantai Lubao Industry & Trade	Rmb	1,650,000.00	-	-	1,650,000.00
Lubao Sales Office	Rmb	500,000.00	-	-	500,000.00
Baosteel Pudong Intl.Trade	Rmb	72,400,000.00	-	-	72,400,000.00
Guangzhou Baosteel Southern Trading	Rmb	30,000,000.00	-	-	30,000,000.00
Guangzhou Baosteel Changjing Materials Delivery	USD	5,086,400.00	-	-	5,086,400.00
Guangzhou International Trade	Rmb	30,000,000.00	-	-	30,000,000.00
Tianjin Baosteel Northern Trading	Rmb	30,000,000.00	-	-	30,000,000.00
Chengdu Baosteel Western Trading	Rmb	30,000,000.00	7,000,000.00	-	37,000,000.00
Baoshan Steel Materials	Rmb	30,000,000.00	63,000,000.00	-	93,000,000.00
Hangzhou Steel Delivery	Rmb	74,280,000.00	-	-	74,280,000.00
Shanghai Baosteel Enterprise	Rmb	38,168,975.65	-	-	38,168,975.65
Shanghai Xinran Metal	Rmb	24,500,000.00	-	-	24,500,000.00
Shanghai Baosteel Automobile Trading	Rmb	50,000,000.00	110,000,000.00	-	160,000,000.00
Shanghai Baosteel Commerce & Trade	Rmb	132,787,000.00	-	-	132,787,000.00
Baosteel Cargo Agency	Rmb	6,000,000.00	-	-	6,000,000.00
Chongqing Baomit Steel Materials Processing & Delivery	Rmb	70,000,000.00	-	-	70,000,000.00
Shanghai Petrol-China Baoshun Petrol-Chemical	Rmb	5,000,000.00	-	-	5,000,000.00
Shenyang Steel Materials Delivery	Rmb	50,000,000.00	-	-	50,000,000.00
Rizhao Baoxin	Rmb	12,650,000.00	-	-	12,650,000.00
Shanghai Shenjing	USD	11,913,300.00	-	-	11,913,300.00
Xinhua Steel	USD	4,950,000.00	-	-	4,950,000.00
Shanghai Baosheng Energy	Rmb	10,000,000.00	-	-	10,000,000.00
Qingdao Baohan Transport & Trading	Rmb	6,000,000.00	-	-	6,000,000.00
Changchun Faw Baoyou	USD	13,614,460.00	-	-	13,614,460.00
Baosteel Trasport	Rmb	50,000,000.00	-	-	50,000,000.00
Baosteel Steel Resources	Rmb	36,000,000.00	-	-	36,000,000.00

## Notes to the Financial Statements (Continued)

31st December, 2006

## VI. Related Party Transactions (Continued)

Name	Currency	Beginning of year	Increase of the year	Decrease of the year	End of year
Shanghai Baomit	USD	29,500,000.00	-	-	29,500,000.00
Qingdao Baomit	Rmb	70,000,000.00	-	-	70,000,000.00
Fuzhou Baomit	Rmb	50,000,000.00	-	-	50,000,000.00
Baoding Energy	Rmb	10,000,000.00	-	-	10,000,000.00
Packing Steel Strap	Rmb	79,000,000.00	-	-	79,000,000.00
Foshan Distribution	Rmb	55,000,000.00	-	-	55,000,000.00
Anhui Steel Materials Delivery	Rmb	50,000,000.00	-	-	50,000,000.00
Baotong Transport	Rmb	5,000,000.00	-	-	5,000,000.00
Baoyang Intl.	Rmb	3,000,000.00	-	-	3,000,000.00
Guangzhou Renhui	Rmb	15,000,000.00	-	-	15,000,000.00
Wuxi Designated M & R Center	Rmb	3,500,000.00	-	-	3,500,000.00
Jiangxi Used Car	Rmb	5,000,000.00	-	-	5,000,000.00
Shanghai Baosteel Used Moto Vehicles Trading	Rmb	15,000,000.00	-	-	15,000,000.00
Jiaxing Baoda	Rmb	18,000,000.00	-	-	18,000,000.00
Shanghai Baole	Rmb	12,000,000.00	-	-	12,000,000.00
Shanghai Baoyou	Rmb	18,000,000.00	-	-	18,000,000.00
Wuhan Baosteel Central Trading	Rmb	30,000,000.00	70,000,000.00	-	100,000,000.00
Baoshan Steel Materials	Rmb	30,000,000.00	-	-	30,000,000.00
Guangzhou Huajing	Rmb	34,380,000.00	17,000,000.00	-	51,380,000.00
Shengsi Baojie	Rmb	3,000,000.00	-	-	3,000,000.00
Chongqing Baosteel	Rmb	-	100,000,000.00	-	100,000,000.00
Shanghai Stainless Steel	Rmb	-	90,000,000.00	-	90,000,000.00
Nanchang Delivery	Rmb	-	74,800,000.00	-	74,800,000.00
Tianjin Delivery	Rmb	-	84,130,000.00	-	84,130,000.00
Guangzou Delivery	Rmb	-	60,000,000.00	-	60,000,000.00
Nanjing Delivery	Rmb	-	83,790,000.00	-	83,790,000.00
Yantai Baomit	Rmb	-	61,000,000.00	-	61,000,000.00
Finance Co., Ltd.	Rmb	500,000,000.00	-	-	500,000,000.00
Yishiqi Energy	Rmb	102,800,000.00	-	-	102,800,000.00
Tiemei Transport	Rmb	600,000.00	-	-	600,000.00
Baoxin Industrial	Rmb	6,000,000.00	-	-	6,000,000.00
Baoxi Computer	USD	600,000.00	-	-	600,000.00
Baojing Information	Rmb	5,000,000.00	-	-	5,000,000.00
Baoli Integration	USD	2,170,000.00	-	-	2,170,000.00
Baokang Electronic	Rmb	20,000,000.00	-	-	20,000,000.00
Japan Baosight	Yen	25,000,000.00	-	-	25,000,000.00
Baoli Automation	Rmb	-	15,000,000.00	-	15,000,000.00
Meishan Design Institute	Rmb	6,000,000.00	-	-	6,000,000.00
Guichi Gangbu	Rmb	10,000,000.00	-	-	10,000,000.00
Baosight Technology	HKD	100,000.00	-	-	100,000.00
Bao-Australia PTY	USD	100,000.00	-	-	100,000.00
Italy Steel Materials	EURO	4,500,000.00	-	-	4,500,000.00

(Rmb)

### 3. Shareholdings and changes of investment by related parties with controlling relationships

Name	Currency	Beginning of year		Additions/Deductions		End of year	
		Investment	%	Investment	%	Investment	%
Baosteel Group	Rmb	13,640,809,539.00	77.89%	74,054,032.00	0.43%	13,714,863,571.00	78.32%
Yantai Lubao	Rmb	79,820,000.00	79.82%	-	-	79,820,000.00	79.82%
Huangshi Coating	USD	3,149,600.00	39.37%	-	-	3,149,600.00	39.37%
Baosteel Intl.Trading	Rmb	2,248,878,553.55	100%	-	-	2,248,878,553.55	100%
Meisteel	Rmb	4,630,487,457.00	74.01%	-	-	4,630,487,457.00	74.01%
Ningbo Baoxin	Rmb	1,538,125,200.00	54%	-	-	1,538,125,200.00	54%
Baosight Software	Rmb	150,044,070.00	57.22%	(4,488,000.00)	(1.72%)	145,556,070.00	55.50%
Baosteel America	USD	980,000.00	100%	-	-	980,000.00	100%
Howa Trading	Yen	876,000,000.00	100%	-	-	876,000,000.00	100%
Baosteel Hong Kong	HKD	62,410,000.00	100%	-	-	62,410,000.00	100%
Baosteel Europe	EURO	2,050,000.00	100%	-	-	2,050,000.00	100%
Baosteel Singapore	SGD	1,500,000.00	100%	-	-	1,500,000.00	100%
Bao-Trans Enterprises	HKD	1,000,000.00	100%	-	-	1,000,000.00	100%
Baosteel Australia	AUD	19,960,000.00	100%	(19,960,000.00)	(100%)	-	-
Baosteel Brazil	USD	980,000.00	100%	-	-	980,000.00	100%
Suzhou Baohua	Rmb	132,000,000.00	60%	45,000,000.00	-	177,000,000.00	60%
Chemical Sales Dept.	Rmb	300,000.00	100%	(300,000.00)	(100%)	-	-
Special Metal	Rmb	-	-	50,000,000.00	100%	50,000,000.00	100%
No. 5 Steel Gas	Rmb	127,015,796.64	99.45%	-	-	127,015,796.64	99.45%
No. 5 Steel Pudong Intl.Trade	Rmb	15,660,000.00	90%	-	-	15,660,000.00	90%
Dongguan Baoste Die Steel	Rmb	30,000,000.00	100%	-	-	30,000,000.00	100%
Anhui Wanbao	Rmb	16,960,000.00	53%	-	-	16,960,000.00	53%
Bsteel Online	Rmb	64,581,920.00	80.73%	-	-	64,581,920.00	80.73%
Lubao Industry	Rmb	1,317,030.00	79.82%	-	-	1,317,030.00	79.82%
Lubao Sales Office	Rmb	399,100.00	79.82%	-	-	399,100.00	79.82%
Pudong Intl.	Rmb	72,400,000.00	100%	-	-	72,400,000.00	100%
Guangzhou Southern Trading	Rmb	30,000,000.00	100%	-	-	30,000,000.00	100%
Baosteel Jingchang	USD	2,594,064.00	51%	-	-	2,594,064.00	51%
Guangzhou Free Trade Zone Intl.Trading	Rmb	30,000,000.00	100%	-	-	30,000,000.00	100%
Tianjin Baosteel Northern	Rmb	30,000,000.00	100%	-	-	30,000,000.00	100%
Chengdu Baosteel Western	Rmb	30,000,000.00	100%	7,000,000.00	-	37,000,000.00	100%
Baosteel Steel Materials	Rmb	30,000,000.00	100%	63,000,000.00	-	93,000,000.00	100%
Hangzhou Baomit	Rmb	48,430,560.00	65.2%	-	-	48,430,560.00	65.2%
Baosteel Enterprise	Rmb	30,535,180.52	80%	-	-	30,535,180.52	80%
Xinran Metal	Rmb	22,540,000.00	92%	-	-	22,540,000.00	92%
Baosteel Automobile	Rmb	50,000,000.00	100%	-	-	50,000,000.00	100%
Baosteel Commerce	Rmb	132,787,000.00	100%	-	-	132,787,000.00	100%
Baosteel Cargo	Rmb	6,000,000.00	100%	-	-	6,000,000.00	100%
Chongqing Baomit	Rmb	57,505,000.00	82.15%	-	-	57,505,000.00	82.15%
Petrol-China Baoshun	Rmb	3,000,000.00	60%	-	-	3,000,000.00	60%
Shenyang Steel Materials Delivery	Rmb	50,000,000.00	100%	-	-	50,000,000.00	100%
Rizhao Baoxin	Rmb	6,451,500.00	51%	-	-	6,451,500.00	51%
Shanghai Shenjing	USD	6,075,783.00	51%	-	-	6,075,783.00	51%
Xinhua Steel	USD	4,455,000.00	90%	-	-	4,455,000.00	90%
Baosheng Energy	Rmb	5,100,000.00	51%	-	-	5,100,000.00	51%

## Notes to the Financial Statements (Continued)

31st December, 2006

## VI. Related Party Transactions (Continued)

Name	Currency	Beginning of year		Additions/Deductions		End of year	
		Investment	%	Investment	%	Investment	%
Qingdao Baohan	Rmb	3,600,000.00	60%	-	-	3,600,000.00	60%
Changchun Faw Baoyou	USD	7,242,075.85	53.19%	-	-	7,242,075.85	53.19%
Baosteel Transport	Rmb	50,000,000.00	100%	-	-	50,000,000.00	100%
Baosteel Steel Resources	Rmb	32,472,000.00	90.2%	-	-	32,472,000.00	90.2%
Shanghai Baomit	USD	19,175,000.00	65%	-	-	19,175,000.00	65%
Qingdao Baomit	Rmb	57,505,000.00	82.15%	-	-	57,505,000.00	82.15%
Fuzhou Baomit	Rmb	35,750,000.00	71.5%	-	-	35,750,000.00	71.5%
Baoding Energy	Rmb	5,100,000.00	51%	-	-	5,100,000.00	51%
Packing Steel Strap	Rmb	71,100,000.00	90%	-	-	71,100,000.00	90%
Foshan Distribution	Rmb	49,940,000.00	90.8%	-	-	49,940,000.00	90.8%
Anhui Steel Materials Delivery	Rmb	35,000,000.00	70%	-	-	35,000,000.00	70%
Baotong Transport	Rmb	4,000,000.00	80%	-	-	4,000,000.00	80%
Baoyang Intl.	Rmb	2,250,000.00	75%	-	-	2,250,000.00	75%
Guangzhou Renhui	Rmb	7,650,000.00	51%	-	-	7,650,000.00	51%
Wuxi Designated M & R Center	Rmb	1,785,000.00	51%	-	-	1,785,000.00	51%
Jiangxi Used Car	Rmb	3,000,000.00	60%	-	-	3,000,000.00	60%
Baosteel Used Motor Vehicles	Rmb	12,150,000.00	81%	-	-	12,150,000.00	81%
Jiaxing Baoda	Rmb	12,600,000.00	70%	-	-	12,600,000.00	70%
Shanghai Baole	Rmb	12,000,000.00	100%	-	-	12,000,000.00	100%
Shanghai Baoyou	Rmb	18,000,000.00	100%	-	-	18,000,000.00	100%
Wuhan Baosteel Central Trading	Rmb	30,000,000.00	100%	70,000,000.00	-	100,000,000.00	100%
Baoshan Steel	Rmb	30,000,000.00	100%	-	-	30,000,000.00	100%
Guangzhou Huajing	Rmb	22,331,529.00	64.96%	11,042,350.00	-	33,373,879.00	64.96%
Shengsi Baojie	Rmb	1,530,000.00	51%	-	-	1,530,000.00	51%
Chongqing Baosteel	Rmb	-	-	100,000,000.00	100%	100,000,000.00	100%
Shanghai Stainless steel	Rmb	-	-	90,000,000.00	100%	90,000,000.00	100%
Nanchang Delivery	Rmb	-	-	38,148,000.00	51%	38,148,000.00	51%
Taijin Delivery	Rmb	-	-	84,130,000.00	100%	84,130,000.00	100%
Guangzhou Delivery	Rmb	-	-	45,000,000.00	75%	45,000,000.00	75%
Nanjing Delivery	Rmb	-	-	83,790,000.00	100%	83,790,000.00	100%
Yantai Baomit	Rmb	-	-	39,650,000.00	65%	39,650,000.00	65%
Finance Co.,	Rmb	310,500,000.00	62.1%	-	-	310,500,000.00	62.1%
Yishiqi Energy	Rmb	73,491,720.00	71.49%	-	-	73,491,720.00	71.49%
Tiemei Transport	Rmb	244,260.00	40.71%	-	-	244,260.00	40.71%
Baoxin Industrial	Rmb	1,652,400.00	27.54%	-	-	1,652,400.00	27.54%
Baoxi Computer	USD	240,300.00	40.05%	(7,200.00)	(1.20%)	233,100.00	38.85%
Baojing Information	Rmb	1,997,000.00	39.94%	(60,000.00)	(1.20%)	1,937,000.00	38.74%
Baoli Integration	USD	657,944.00	30.32%	(19,747.00)	(0.91%)	638,197.00	29.41%
Baokang Electronic	Rmb	8,583,000.00	42.92%	(258,000.00)	(1.29%)	8,325,000.00	41.63%
Japan Baosight	Yen	14,305,000.00	57.22%	(430,000.00)	(1.72%)	13,875,000.00	55.50%
Baoli Automation	Rmb	-	-	4,245,750.00	28.31%	4,245,750.00	28.31%
Meishan Design Institute	Rmb	-	-	3,163,500.00	52.73%	3,163,500.00	52.73%
Guichi Gangbu	Rmb	3,180,000.00	31.8%	-	-	3,180,000.00	31.8%
Baosight Technology	HKD	100,000.00	100%	-	-	100,000.00	100%
Bao-Australia PTY	USD	100,000.00	100%	-	-	100,000.00	100%
Italy Steel Materials	EURO	2,295,000.00	51%	-	-	2,295,000.00	51%

(Rmb)

#### 4. Related parties with no controlling relationships

Related parties which have transactions with the Company, its subsidiaries and jointly-controlled entities, but with no controlling relationships, are all subsidiaries of Baosteel Group.

#### 5. Details of related party transactions between the Group and Baosteel Group and related parties

##### (1) Details of sales to related parties:

Name of related party	Footnote	2006 Rmb'000	2005 Rmb'000
Sustained Transactions			
Baosteel Group	(I)a	21,901	30,424
SBGC Shanghai No. 1 Steel	(I)b	524,416	2,705,387
SBGC Shanghai No. 2 Steel	(I)b	627,595	1,344,329
SBGC Shanghai No. 5 Steel	(I)b	119,597	207,054
SBGC Shanghai Pudong Steel	(I)b	2,225,542	4,704,725
SBGC Shanghai Steel Tubes	(I)b	291,079	108,471
Yantai Lubao Industry & Trade	(I)b	144,057	150,573
Baosteel Group Lubao Sales Office	(I)b	38,817	28,847
Baosteel Group Enterprise Development	(I)b	3,785,955	2,767,973
Shanghai Baosteel Construction Technology	(I)b	90,209	84,230
Baosteel Industrial Development	(I)b	286,271	193,608
Baosteel-NSC/Arcelor	(I)b	3,631,447	3,339,227
Shanghai Meishan Steel	(I)b	1,799,806	1,727,072
Baosteel Group Baori Wire	(I)b	86,321	60,487
Nantong Baogang Nippon	(I)b	362,429	303,759
Shanghai Baosteel Equipment Examination & Maintenance	(I)b	11,855	22,466
Baosteel Industrial Examination	(I)b	1,358	3,817
Baosteel Technology & Economics	(I)b	296,816	503,237
Baosteel trading	(I)b	1,315,775	-
Welding Company	(I)b	112,198	55,270
Tianjin BCM	(I)b	14,231	34,482
Others	(I)b	11,989	38,200
Total		15,799,664	18,413,638
Non-sustained Transactions			
Shanghai Baosteel Intl. Trading and overseas subs of Baosteel Group	(I)c	-	18,326,531
SBGC Shanghai No. 1 Steel	(I)d	-	294,788
Shanghai Baosteel Chemical	(I)d	-	590,015
Meisteel	(I)d	-	64
Japan Baosight	(I)d	-	915
Total		-	19,212,313

## Notes to the Financial Statements (Continued)

31st December, 2006

## VI. Related Party Transactions (Continued)

## (2) Details of purchases from related parties:

Name of related party	Footnote	2006 Rmb'000	2005 Rmb'000
Sustained Transactions			
SBGC Shanghai No. 1 Steel	(2)a	1,137,008	43,390
SBGC Shanghai No. 2 Steel	(2)a	52,931	42,852
SBGC Shanghai No. 5 Steel	(2)a	107,398	80,617
SBGC Shanghai Pudong Steel	(2)a	1,266,796	909,634
Shanghai Baosteel Construction Technology	(2)a	491,772	583,645
Baosteel Group Enterprise Development	(2)a	966,695	780,304
Nantong Baogang Nippon	(2)a	192,631	46,824
Baosteel Industrial Development	(2)a	18,625	14,863
Yantai Lubao Industry & Trade	(2)a	7,493	-
Baosteel Group Lubao Sales Office	(2)a	-	5,035
Baosteel-NSC/ Arcelor Auto Sheets	(2)a	4,481,655	3,376,979
Baosteel Industrial Examination	(2)a	15,084	49,828
Shanghai Baosteel Equipment Examination & Maintenance	(2)a	248,293	84,694
SBGC Shanghai Steel Tubes	(2)a	3,421	6,959
Shanghai Meishan Steel	(2)a	790,978	575,464
Henan Zhenglong	(2)a	-	318,520
Baosteel Technology & Economics	(2)a	59,039	482,648
Baosteel Trading	(2)a	226,029	-
Tianjin BCM	(2)a	162,638	806
Others	(2)a	936	13,856
Total		10,229,422	7,416,918
Non-sustained Transactions			
Shanghai Baosteel Intl. Trading and overseas subs of Baosteel Group	(2)b	-	4,235,598
Shanghai Baosteel Chemical	(2)c	-	641,645
Japan Baosight	(2)c	-	23,244
SBGC Shanghai No. 1 Steel	(2)c	-	529,161
Total		-	5,429,648

(Rmb)

## (3) Other related party transactions by the Company/Group and Baosteel Group:

Name of related party	Footnote	2006 Rmb'000	2005 Rmb'000
Sustained Transactions			
Transportation services	(3)a	36,966	21,134
Technical services	(3)b	37,512	24,966
Examination & testing	(3)c	25,093	21,300
Examination & maintenance	(3)d	920,167	877,973
Examination & checkout	(3)e	28,322	39,080
Research & technical support	(3)f	4,462	14,980
Processing services	(3)g	166,106	137,197
Training & development	(3)h	22,410	9,993
Logistics services	(3)i	1,419,090	1,171,034
Transportation fees	(3)j	618,976	416,409
Use of land	(3)l	131,528	131,878
Interest income	(3)m	10,241	13,116
Interest expense	(3)m	269,347	149,850
Interest expenses at acquisition of Phase-3 assets	(3)n	148,000	184,000
Engineering expense	(3)o	523,722	223,043
Raw materials warehousing, shipping & labor services	(3)q	95,122	95,219
Equipment and subsidiary material agency income	(3)s	25,868	23,244
House leasing	(3)t	65,354	9,766
Non-Sustained transactions			
Transportation services	(3)a	-	8,992
Examination & maintenance	(3)d	-	4,350
Research & technical support	(3)f	-	19,172
Sales agency services	(3)k	-	29,125
Income from administration	(3)p	-	13,666
Acquisition of target companies	(3)r	-	17,924,439
Acquisition of target assets	(3)r	-	16,102,544

## Footnotes:

(1) Sales of products to the related party

(a) In 2006, the Group mainly sold Baosteel Group energy, raw materials and spare parts at market prices for a total amount of Rmb 21,900,624 (2005: Rmb 30,423,988)

(b) SBGC Shanghai No. 1 Steel (No. 1 Steel), SBGC Shanghai No. 2 Steel (No. 2 Steel), SBGC Shanghai No. 5 Steel (No. 5 Steel), SBGC Shanghai Pudong Steel (Pudong Steel), SBGC Shanghai Meishan Iron & Steel (Meishan Company), Shanghai Baosteel Technology and Economics Development (Baosteel Technology & Economics), Baosteel Group Enterprise Development Corporation (Development Corporation) and Baosteel Trading Co., Ltd are all 100% owned subsidiaries of Baosteel Group. Since the Group purchased some steel-making assets from Baosteel Group on 1st May 2005, the Group has provided the previous six companies steel and steel products and byproducts to these companies at market prices. Since July 21, 2006 when Baosteel Trading Co., Ltd was founded, the Group has provided it ores at market price. In 2006, the Group sold to these subsidiaries a value of Rmb 12,700,608,009 (2005: Rmb 15,109,187,286) of major products and byproducts and of Rmb 2,341,482,310 (2005: Rmb 2,880,503,653) of other materials.

The sales of drinking water; industrial water; purified water; filtered water; electricity, and other types of energy the Group made to some of Baosteel Group's subsidiaries at the market price totaled Rmb 376,532,033 in 2006, as compared to Rmb 292,302,156 in the previous year.

The total value of spare parts the Group sold to some the Baosteel Group's subsidiaries reached Rmb 359,140,874 in 2006, as apposed Rmb 101,221,194 in 2005.

## Notes to the Financial Statements (Continued)

31st December, 2006

### VI. Related Party Transactions (Continued)

- (c) Since 1st May 2005, when the Group finished its new share issuance and acquisition, the transaction of steel products, metallurgical coke, spare parts, and other types of energy between the Group to Baosteel International and its subsidiaries and the overseas subsidiaries of Baosteel Group as the above was terminated. (2005 witnessed a total value in transaction of Rmb 18,326,531,006, including the transaction of steel products of Rmb 18,010,846,325, metallurgical coke of Rmb 292,783,907, materials and spare parts of Rmb 22,109,351, and other types of energy medium of Rmb 791,423.)
- (d) Since 1st May 2005, when the Group finished its new share issuance and acquisition, the transactions of metallurgical coke, raw coal gas, energy medium, materials and spare parts between the Group and SBGC No. 1 Steel, Baosteel Chemical, Meisteel, and Baosight Software were terminated. (2005 witnessed a total value of transaction of Rmb 885,782,087, among which sale of metallurgical coke and raw coal gas was Rmb 708,981,459, energy medium Rmb 134,056,011, and materials and spare parts Rmb 42,744,617.)
- (2) Purchases from related parties
- (a) The Group has been purchasing spare parts from No. 5 Steel and Meisteel, materials, such as steel products and raw materials, from No. 1 Steel, Baosteel Technology & Economics, Meisteel and Henan Zhenglong, and energy medium from No. 1 Steel. All purchases have been conducted at market prices.
- The minor fixed assets, spare parts, materials and energy the Group bought from the above companies in 2006 totaled Rmb 346,868,294 (2005: Rmb 540,203,005), Rmb 500,554,756 (2005: Rmb 455,763,073), Rmb 9,208,350,139 (2005: Rmb 6,258,369,427) and Rmb 173,648,540 (2005: Rmb 162,582,330), respectively.
- (b) Since 1st May 2005, when the Group finished its new share issuance and acquisition, the transactions of raw materials, subsidiary materials, and spare parts between the Group and Baosteel International and its subsidiaries and the overseas subsidiaries of Baosteel Group as the above were terminated. (2005 witnessed a total value of transaction of Rmb 4,235,598,099, among which the raw materials, subsidiary materials and spare parts were Rmb 4,166,003,121 and the commission fee was 69,594,978.)
- (c) Since 1st May 2005, when the Group finished its purchase program, the transactions of refined gas, soft pitch, minor items of fixed assets and materials between the Group and Baosteel Chemical, Baosight Software, and No. 1 Steel were terminated. (2005 witnessed a total value of transactions of Rmb 1,194,049,612, among which refined gas was Rmb 623,624,604, soft pitch Rmb 18,020,611, minor items of fixed assets Rmb 23,243,772 and other materials Rmb 529,160,625.)
- (3) Other related party transactions
- (a) The Group provided transportation services in the Baoshan plant site for Baosteel Industrial Examination (hereinafter referred to as the "Examination Company"), Meisteel, Pudong Steel, Baijiang Shipping and Baosteel International (including its subsidiaries) based on contracted prices.
- Since 1st May 2005, when the Group finished its new share issuance and acquisition, the relationships of the Group to Baosteel International and its subsidiaries were terminated.
- (b) The Group has provided Baosteel-NSC/Arcelor Auto Sheets and Baosteel Group and its subsidiaries with research projects, quality examination and testing and other technical services, at contracted prices.
- (c) The Group has served as the examiner and tester for Baosteel-NSC/Arcelor Auto Sheets, with fees as agreed upon by the two parties in reference to the market price.
- (d) Shanghai Baosteel Equipment Examination & Testing (Baosteel Examination), Baosteel Engineering Technology (Engineering Company), SBGC Enterprise Development (Development Company), Shanghai Baosteel Industrial Development (Industrial Company), Shanghai Baosteel Industrial Examination & Testing (Examination & Testing Company) are the subsidiaries of Baosteel Group. No. 1 Steel, Meisteel, No. 5 Steel, Industrial Company, Engineering Company, Examination & Testing Company, Baosteel Examination, and Technical Company provided the Group with services of equipment and spare parts repair and maintenance and emergency repair for production facilities, equipment and machinery, electrical facilities, meter and measurement apparatus, plant structuring, and site development and construction. The service fees were based on market prices.
- Since 1st May 2005, when the Group finished its new share issuance and acquisition, the related transactions of maintenance service between the Group and Baosight Software were terminated.
- (e) As a 100% owned subsidiary of Baosteel Group, Examination Company provided the Group with examination and testing services for production facilities. Service fees were based on market prices.
- (f) The Engineering Company, Examination Company, and Shanghai Pudong Steel provided, at negotiated prices, technical service to the Group. Baosteel International and Baosteel Group Baoshan Hotel (Baoshan Binguan) provided, technical research related logistics services for the Group. Baosight provided services for the operation of computer systems and checking points as well as maintenance and system development.
- Since 1st May 2005, when the Group finished its new share issuance and acquisition, the relationships of the Group to Baosteel International and Baosight Software were terminated.
- (g) No. 5 Steel served as a provider of spare parts processing for the Group at negotiated prices. Baosteel-NSC/Arcelor and Meishan Company, new service providers have been processing steel products and supplementary materials for the Group at negotiated prices in 2006.
- (h) Baosteel Group provided training to staff of the Group at negotiated prices.

- (i) The Development Corporation and its subsidiaries, Meishan Company, No. 1 Steel, and No. 5 Steel provided, at the negotiated prices, services including cleaning, environmental safety, traffic control, food supplies, property management, and non-production maintenance, medical care and hygiene as well as production outsourcing.
- (j) Baojin Shipping, an overseas subsidiary of Baosteel Group, Meishan Company, No. 1 Steel, and No. 5 Steel are paid by the Group at negotiated prices for transportation services.
- (k) Since 1st May 2005, when the Group finished its new share issuance and acquisition, the sales agency relationship of the Group to Baosteel International and its subsidiaries was terminated. (2005: Rmb 29,125,111)
- (l) When founded, the Company signed a twenty-year agreement with Baosteel Group for the lease of the plant site land. In September 2001, the Company signed a further twenty-year lease agreement with Baosteel Group for the use of the land for the plant site for assets acquired in Phase-3. The annual rental payments set out in the above lease agreements are Rmb 74mn and Rmb 32mn respectively. In November 2002, the Company signed a new twenty-year lease agreement with Baosteel Group for the land use of the plant site for assets in custody due to acquisitions, with the original annual rental payment of Rmb 22,800,000, which was reduced to Rmb 20,540,000 since May 2003. In August 2004, Bao-NSC/Arcelor Auto Sheets, a joint-venture partner of the Group, signed a twenty-year lease contract with Baosteel Group for land use of the plant site. In the past year, the Group made an actual rental payment for Rmb 131,527,568 (2005: Rmb 131,877,500) to Baosteel Group.
- (m) The Financial Company, as an unconsolidated sub-subsidiary of the Company, absorbs funds from and pays an interest to the Group. The income derived from the process is calculated according to the interest rate as stipulated by the People's Bank of China. In addition, the Financial Company provides foreign currency loans to the Group. The interests are calculated and paid on the basis of Libor+1%.  
  
Huabao Trust Co., Ltd lends short-term loans to Bao-NSC/Arcelor Auto Sheets of Rmb 170 million of which is calculated and paid with an annual interest of 5.022% and Rmb 330 million of which with an annual interest rate of 4.4%.
- (n) In accordance with the *Supplementary Agreement of the Acquisition of Assets for Baosteel Phase-3 Construction*, the deferred interest related to acquisition payments by the Group to Baosteel Group is paid in the last five working days of December each year from 2002 to 2009. Refer to (29) of Note 5 for details.
- (o) The Engineering Company provided engineering design services, construction installation and management for the Group, with service fees based on negotiated rates. The Development Company and Meishan Company have been involved in the construction, supervision, and cost consultation and auditing work of the Group, with fees based on contracted rates.
- (p) Since 1st May 2005, when the Group finished its new share issuance and acquisition, the related transaction entrusted to the Group by Baosteel Group for the management of Majishan Harbor has no longer existed.  
  
According to the *Trust Agreement of Joint Venture Factory Construction and Management Services* signed by the Group and Bao-NSC/Arcelor Auto Sheets in 2004, the Group provided management services for design, purchasing, and construction for the facilities and materials for the joint venture factory, on the basis of the management fee of 2.5% of the construction budget. Up to December 31, 2005, the joint venture factory project had been completed and transferred into the fixed assets. Therefore, this related party transaction does not exist in 2006.
- (q) The Examination Company is a 100% controlled subsidiary of Baosteel Group and provides material warehousing and transportation at negotiated prices.
- (r) On 1st May 2005, the Company purchased part of the companies and assets of Baosteel Group, with respective payments of Rmb 17,924,439,180.30 and Rmb 16,102,544,187.56. All the target companies and assets, excluding Meishan Real Estate, were evaluated as on 30th June 2004. The final prices were decided by taking into consideration of the net values of the target companies or assets, as specified in the asset Appraisal reports prepared by China Asset Appraisal Co., Ltd., Zhongxi CPA Firm, Beijing Zhongqihua Asset Appraisal Co., Ltd., and Shanghai Dongzhou Asset Appraisal Co., Ltd., the changes in net value or in after-tax profit from the appraisal day to the settlement day, and the interests derived during the period. Meishan Real Estate was purchased at the price as evaluated on the appraisal day. In 2006, the Company stopped purchasing the stock ownership of Bao-Australia PTY held by Baosteel Group and no longer transacted the relevant legal formalities. For details refer to note 1 of Notes 4 (2).
- (s) The Group sold subsidiary materials and spare parts to Baosteel Examination, Engineering Company, Development Company and the Examination Company, with an agent fee of no more than 2.5%.
- (t) The Group leased houses from such related parties as Baoshan Hotel at negotiated prices.
- (u) At the balance sheet date, Baosteel Group Finance Co., Ltd. has provided guarantee for the Group's offshore bank loans with a total amount of Rmb 317,785,803.12.

## 6. Outstanding balances of receivable & payable with related parties and cash deposited with related parties:

Refer to Paragraphs (1), (3), (4), (5), (6), (7), (18), (19), (20), (21), (22), (25), (27), (28) and (29) in Note 5.

## Notes to the Financial Statements (Continued)

31st December, 2006

## VII. Contingent Liabilities

As at the balance sheet date, the Company and the Group had not incurred contingent liabilities required for disclosure.

## VIII. Commitments

## Capital commitments

	The Group	
	Dec. 31, 2006	Dec. 31, 2005
Contracted and yet appropriated	25,395,276,062.10	33,721,860,567.66
Approved and yet contracted	10,799,139,792.51	2,460,092,188.88
Total	36,194,415,854.61	36,181,952,756.54

## Operating Lease commitment

The Group is committed to the following minimum irrevocable operating lease payments for three consecutive fiscal years after the balance sheet date and for the years following:

	The Group	
	Dec. 31, 2006	Dec. 31, 2005
First year	147,103,917.41	156,740,560.22
Second year	147,155,998.73	145,834,100.56
Third year	142,106,392.11	141,359,159.68
Following years	1,534,301,321.35	1,638,407,065.59
Total	1,970,667,629.60	2,082,340,886.05

## IX. Items After the Balance Sheet Date

- (1) According to the resolution of the 5th Meeting of the Third Board of Directors held on 29th March 2007, the Directorate suggested a total cash dividend of Rmb 6,129,200,000.00, on the basis of Rmb 3.5 (including tax) for every ten shares. The suggestion has been submitted to the 2006 Shareholders' General Meeting for approval.
- (2) According to the regulation of *The 33rd Decree* and *The Notice on the Publication of 38 Concrete Standards Including Accounting Standards for Enterprises No. 1—Inventories* issued by the Ministry of Finance, the Group starts to implement the new accounting standards for enterprises from January 1, 2007 and adjusts the balance sheet of January 1, 2007 in accordance with the requirements stipulated in *Accounting Standard for Business Enterprises No. 38 - First time adoption of Accounting Standards for Business Enterprises*. The Company has collated and stipulated appropriate accounting policies and made rational accounting estimates based on the new standards for enterprises and the reality of the Company. It has prepared a table of shareholders' equity difference adjustment in the old and new accounting standards as a supplement to the financial statement to disclose the influence on shareholders' equity in the consolidated balance sheet of January 1, 2007 caused by the adoption of the new accounting standard.
- (3) The 5th Session of the 10th National People's Congress, which ended on March 16, 2007, passed *The Corporate Tax Law* of the PRC (the new corporate tax law), which shall be implemented from January 1, 2008. The new corporate tax law introduces a series of changes including standardize the tax rate of domestically and foreign funded enterprise into a unified 25%. As the details for implementation and the method of management is not yet published, we can not make a rational assessment of the influence of the implementation of the new corporate law on the future finance of the Group.

## X. Other Significant Items

### Untradable share reform

#### 1. Untradable share reform and its implementation

In accordance with the reform program reviewed and approved on the 2005 First Interim Shareholders' Meeting held on 12th August 2005, the Baosteel Group, the only non-tradable shareholder of the Company, shall make tradable its shares in the consideration of a payment of 2.2 shares for every ten tradable shares the holders have registered on the day of registration and a European style warrant of subscription right with an expiry period of 378 days till 18th August 2006 and an excise price of 4.50. The non-tradable share of the Group shall circulate on market when credits are made to the accounts of the shareholders. After the implementation of the program, the total capital stock of the Company is still 17,512,000,000 and financial indexes such as company assets, debts, owners' rights and interests, and income-per-share remain what they are.

Baosteel Group has made the following promises: The Group shall not sell the new shares and is obliged to disclose the related information within the six months after the implementation of the program; within the twelve months since it is entitled the right to trade its shares, the Group shall not sell or transfer the Company's shares, and only twenty-four months after the entitlement the Group's shares shall be listed on the market; the total sales of the Company's shares the Group has conducted in stock exchanges within the next twelve months after the twenty-four months' period shall not be more than five per cent of the total share of the Company and the price shall not be less than 5.63 per share; and within the three years since the entitlement, the shares of the Company that the Group own shall not be less than 67 per cent of the total of the Company. However, new shares of the Company that the Group has acquired after the reform program shall be out of the province of the above limitations in regard of trading and transferring.

Baosteel Group has also promised that, if the A share price of the Company fall at a level below 4.53 per share two months after the approval of the untradable share reform by the Shareholders' General Meeting, the group shall inject no more than Rmb 2 billion in the aggregation to purchase the general public shares of the Company by means of competitive pricing at the Stock Exchange of Shanghai. The Group shall not sell the newly increased shares and is obliged to disclose the related information within the six months after the promotion program. Up to 21st September 2005 the Group had fulfilled the promise of Rmb 2 billion injection, with its holding of the Company increased by 446,565,849 shares.

#### 2. Second purchase of the Company's shares by Baosteel Group

In order to further the non-tradable share reform program so as to prevent the Company's shares from irrational fluctuating and protect the interests of the investors, Baosteel Group made further efforts by promising that, in case that the share price of the Company drop to a level below 4.53 per share six months after the above-mentioned two-month period, the Group shall inject another sum of no more than Rmb 2 billion in the aggregation, together with the remaining of the first injection if it has not been used up, to purchase the Company's shares by means of competitive pricing at the Stock Exchange of Shanghai until the promised sum has been used up or the Company's shares rise at a level above 4.53 per share. The commitment shall be fulfilled on the condition that the China Securities Regulatory Commission exempts the Group from the duties of compulsive acquisition offer of the company's stocks and that the non-tradable share reform program is approved by the Company's Shareholders' General Meeting. The Group shall not sell the newly purchased shares and is obliged to disclose the related information within the six months after the supporting program. The No. [2005]95 Document issued by the China Securities Regulatory Commission has agreed to exempt the Group from the duties in the purchase referred to. Up to 5th January 2006 the Group had fulfilled the promise of the second Rmb 2-billion injection, with its holding of the Company's shares increased by 491,780,281.

#### 3. Implementation of the untradable share reform in 2006

On April 15, 2006, the six-month time limit for share selling of the Company's 446,565,849 shares held by Baosteel Group with the first injection of Rmb 2 billion expired and these shares could be circulated on market. On August 31, the European warrants expired and part of the tradable shareholders purchased 5,542,559 shares of the Company by exercising the warrants. On October 16, 2006, the six-month time limit for share selling of the Company's 491,780,281 shares held by Baosteel Group with second injection of Rmb 2 billion expired and these shares could be circulated on market.

#### 4. Cash dividends for 2005-2007 periods

On the basis of the policy approved on the 2004 Shareholders' General Meeting of the Company, the Board of Directors has agreed to submit to the 2005, 2006 and 2007 meetings the suggestion that the cash dividend in the annual profit distribution program be no less than Rmb 0.32 per share, so as to keep stable expectations among the shareholders in the period of the reform.

## Notes to the Financial Statements (Continued)

31st December, 2006

(Rmb)

## XI. Supplementary Data to Income Statements

Items	The Group		The Company	
	2006	2005	2006	2005
Sales and disposal of business units and losses for invested companies	(144,587,196.76)	6,051,716.42	(198,859.72)	-
Losses from natural disasters	-	-	-	-
Increase/(decrease) of pre-tax profits due to changes in accounting policies	-	-	-	-
Increase/(decrease) of pre-tax profits due to changes in accounting estimates	-	-	-	-
Losses from debt restructuring	-	-	-	-

## XII. Comparative Figures

Certain comparative figures have been reclassified to conform to the presentation format of the current period.

## XIII. Approval of the Financial Statements

The *Financial Statements* have been reviewed and approved pursuant to the Board Meeting resolution passed on 29th March 2007.

(Rmb)

## I. Fully-diluted and Weighted Average Return-on-Equity and Earnings-Per-Share

Items	Profit during reported period (000,)	Return-on-equity		Earnings-per-share (Rmb)	
		Fully diluted	Weighted average	Fully diluted	Weighted average
Principle businesses	27,893,077	34.03%	36.11%	1.59	1.59
Operating profits	18,984,009	23.16%	24.58%	1.08	1.08
Net profits	13,010,265	15.87%	16.84%	0.74	0.74
Net profits excluding extraordinary items	13,246,546	16.16%	17.15%	0.76	0.76

Net Profits excluding extraordinary items

	2006 Rmb (000,)	2005 Rmb (000,)
Net profits	13,010,265	12,665,529
Extraordinary items: add (less)		
Short-term investment income	(96,334)	(51,381)
Income from disposal of long-term equity investment	144,587	(6,052)
Government subsidies income	(44,735)	(25,080)
Non-operating income/ (expenses) after deduction of asset losses provisions required by company accounting system	343,380	197,055
Write-back of provisions booked in previous years	(447)	(633)
Tax effects of non-operating income/ (losses)	(110,170)	(36,486)
Net gains excluding extraordinary items	13,246,546	12,742,952

The extraordinary items as listed above are calculated based on the formulae stipulated in the No.1 of *Issues of Disclosure of Information for Publicly Listed Companies* issued by the China Securities Regulatory Commission with the serial number [2004]4.

## Supplementary Information (Continued)

31st December, 2006

(Rmb)

## II. Details of provisions of asset losses

## The Group

Items	Opening amount	Increase for the year	Deduction for the year			Closing amount
			Value pickup	Other causes	Total	
1. Provisions of bad debts	481,398,466.52	176,450,140.19	-	(140,929,494.02)	(140,929,494.02)	516,919,112.69
Accounts receivables	343,970,128.83	154,122,928.99	-	(132,885,394.78)	(132,885,394.78)	365,207,663.04
Other receivables	137,428,337.69	22,327,211.20	-	(8,044,099.24)	(8,044,099.24)	151,711,449.65
2. Short-term investment losses	4,265,628.09	-	-	(4,265,628.09)	(4,265,628.09)	-
Stock investment	4,265,628.09	-	-	(4,265,628.09)	(4,265,628.09)	-
Bond investment	-	-	-	-	-	-
3. Valuation losses of inventories	868,827,774.30	110,157,322.24	(758,455,457.21)	-	(758,455,457.21)	220,529,639.33
Stock in the inventory	315,156,363.77	48,432,421.29	(262,788,244.86)	-	(262,788,244.86)	100,800,540.20
Raw materials	152,842,973.72	1,611,159.37	(148,659,828.57)	-	(148,659,828.57)	5,794,304.52
4. Fixed assets impairment losses	51,942,727.42	2,998,202.29	-	(25,187,672.59)	(25,187,672.59)	29,753,257.12
Houses and building	32,634,723.65	-	-	(17,832,106.95)	(17,832,106.95)	14,802,616.70
Machinery equipment	16,164,352.81	2,183,203.41	-	(6,957,470.80)	(6,957,470.80)	11,390,085.42
5. Total	1,406,434,596.33	289,605,664.72	(758,455,457.21)	(170,382,794.70)	(928,838,251.91)	767,202,009.14

## The Company

1. Provisions of bad debts	341,920,119.90	94,110,313.11	-	(117,598,241.08)	(117,598,241.08)	318,432,191.93
Accounts receivables	328,722,677.26	93,474,438.19	-	(108,452,105.60)	(108,452,105.60)	313,745,009.85
Other receivables	13,197,442.64	635,874.92	-	(9,146,135.48)	(9,146,135.48)	4,687,182.08
2. Valuation losses of inventories	574,956,835.57	68,892,159.70	(506,203,124.23)	(506,453.62)	(506,709,577.85)	137,139,417.42
Stock in the inventory	195,958,567.18	20,153,470.32	(193,877,632.78)	(506,453.62)	(194,384,086.40)	21,727,951.10
Raw materials	104,764,271.30	1,611,159.37	(101,451,133.88)	-	(101,451,133.88)	4,924,296.79
3. Fixed assets impairment losses	4,434,031.76	2,653,204.23	-	(622,173.67)	(622,173.67)	6,465,062.32
Houses and building	-	-	-	-	-	-
Machinery equipment	3,963,416.39	2,183,203.41	-	(617,285.79)	(617,285.79)	5,529,334.01
4. Total	921,310,987.23	165,655,677.04	(506,203,124.23)	(118,726,868.37)	(624,929,992.60)	462,036,671.67

# Review Report of the Table of Shareholders' Equity Difference in the Old and New Accounting Standards of Baosteel Co., Ltd

No. 60428378\_B02 audited by Ernst & Young Hua Ming (2007)

To the Shareholders of Baoshan Iron & Steel Company Limited (the "Company")

We, Ernst & Young Hua Ming, have audited the Table of Shareholders' Equity Difference Adjustment (hereinafter referred to as the "Difference Adjustment Table") of Baosteel Co., Ltd (hereinafter referred to as "Your Group") based on the old and new accounting standards dated December 31, 2006 and January 1, 2007, following the basis of note preparation as specified in Note 2. Preparing a difference adjustment table based on the relevant regulations as stipulated in Accounting Standard for Business Enterprises No. 38 - First time adoption of Accounting Standards for Business Enterprises and the Notice on the Disclosure of Financial Accounting Information Related to the New Accounting Standard (the 136th document of China Securities Regulatory Commission in 2006. Hereinafter referred to as "The Notice") is the responsibility of the management team of Your Group. Our responsibility is to produce a review report on the difference adjustment table base on auditing.

According to the relevant regulations of The Notice, we implemented the review with reference to Standard on Review Engagements for CPAs of China---No. 2101-Engagements to Review Financial Statements, which requires that we plan and perform the review so as to provide sufficient evidence for a limited warranty as to whether the difference adjustment is free from material misstatement. The review is mainly restricted to consulting relevant employees of the Company for the relevant accounting policy of the difference adjustment table and all the important confirmations, getting to know the calculation process of the amount of money in the table, reading the table to ascertain that the it is prepared following the specified basis of preparation, and if necessary, implementing the analyzing procedures. The warranty provided by a review is lower than that of an auditing. We did not audit the difference adjustment table and therefore did not give any auditing opinion.

According to our review, we did not notice anything that makes us believe that, in terms of some major aspects, the above difference adjustment table was prepared against the relevant regulations of Accounting Standard for Business Enterprises No. 38 - First time adoption of Accounting Standards for Business Enterprises and The Notice.

Ernst & Young Hua Ming    Certified Public Accountants

Beijing, P. R. China

Registered in P.R.China

Ge Ming

Zhang Xiaodong

29th March 2007

## Important Notice:

Baosteel Co., Ltd (hereinafter referred to as The Company) and its subsidiaries and joint venture enterprises (hereinafter referred to as the Group) start to perform the Enterprise Accounting Standard issued on January 1, 2007 by the Ministry of Finance of PRC (hereinafter referred to as the "New Accounting Standard"). Presently, the Company is assessing the influence on the Group's financial situation, operational results, and cash flow by the implementation of the new accounting standard. After careful consideration and with reference to the further interpretation of the new accounting standard by the Ministry of Finance, the Company, in preparing the 2007 financial statement, may possibly adjust the relevant accounting policy or important confirmations adopted in preparing the Table of Shareholders' Equity Difference in the Old and New Accounting Standards (hereinafter referred to as the Difference Adjustment Table), which may cause difference in the shareholders' equities on January 1, 2007 (new accounting standard) and in the 2007 financial statement as listed in the difference adjustment table.

## Table of Shareholders' Equity Difference in the Old and New Accounting Standards

Monetary unit: RMB yuan

Item	Notes	Project names	Amount
		Shareholders' equity on Dec. 31, 2006 (current accounting standard)	81,960,545,925.11
1	Note 3 (2)	Business enterprises merger	(618,849,558.38)
		Book value of combined goodwill (equity investment difference) of corporations under the same control	(351,890,262.71)
		Book value of long-term deferred expenses due to absorption and merger	(266,959,295.67)
2	Note 3 (3)	Financial assets and available-for-sale financial assets based on fair value measurement, whose changes are accounted into current profit and loss	101,923,400.35
3	Note 3 (4)	Derivative financial instruments	(8,720,893.65)
4	Note 3 (5)	Income tax	(122,436,804.98)
5	Note 3 (6)	Influence of the above adjustment on minority shareholders' equity	(27,256,008.33)
		Shareholders' equity belong to the parent company by Jan. 1, 2007 (new accounting standard)	81,285,206,060.12
6	Note 3 (7)	Change of minority shareholders' equity due to the change of the scope of merger	312,043,707.48
7	Note 3 (8)	Changes in the list of minority shareholders' equity	4,941,492,138.80
		Shareholders' equity on Jan 1, 2007 (new accounting standard)	86,538,741,906.40

The following note to the above table is part of the table.

Statutory representative: Xu Lejiang

Financial controller: Chen Ying

Chief accountant: Wang Mingdong

## Table of Shareholders' Equity Difference in the Old and New Accounting Standards

(Unless otherwise specified, the monetary unit is RMB yuan)

### (1) Purpose for notes preparation

The Group starts to implement the new accounting standard from January 1, 2007. In order to analyze and disclose the impact of the new accounting standard on the finance of listed companies, China Securities Regulatory Commission issued the Notice on the Disclosure of Financial Accounting Information Related to the New Accounting Standard (the 136th document of China Securities Regulatory Commission in 2006. Hereinafter referred to as "The Notice"), requiring the Company to follow the relevant regulations of Accounting Standard for Business Enterprises No. 38 - First time adoption of Accounting Standards for Business Enterprises and The Notice and disclose the process of major difference adjustment by means of a difference adjustment table in a supplement to the 2006 financial statement.

### (2) Basis for notes preparation

The difference adjustment table is prepared in the order of importance on the basis of the consolidated financial statement of 2006 and the characteristics and reality of the Group, following the relevant regulations stipulated in the 5-19 provisions in Accounting Standard for Business Enterprises No. 38 - First time adoption of Accounting Standards for Business Enterprises and The Notice.

In addition, the difference adjustment table is prepared on the following principles for the items below:

(1) Subsidiaries, jointly venture enterprises and joint ownership enterprises make adjustment according to the regulations stipulated in the 5-19 provisions of Accounting Standard for Business Enterprises No. 38 - First time adoption of Accounting Standards for Business Enterprises. For items that affect the retained earnings of the aforementioned companies and shares of net assets the Group is entitled to have in accordance with its share proportion, the Company shall make due adjustment of its retained earnings or capital reserve based on its business operation.

(2) Because of the preparation of a consolidated financial statement, the Company adjusts its minority shareholders' equity in accordance with the new accounting standard, which is reflected in the separate listings of the difference adjustment table.

## III. Notes to major items

(1) The amount of shareholders' equity (current accounting standard) on December 31, 2006 is taken from the consolidated assets balance sheet prepared on December 31, 2006 following the current Accounting Standard and China Accounting System for Business Enterprises (Hereinafter referred to as the "Current Accounting Standard"). This statement has been audited by Ernst & Young Hua Ming, which issued on March 29, 2006 an audit report without any reservation of opinion labeled as No. 60428378\_B01 (Ernst & Young Hua Ming 2007). For the basis of the statement preparation and the major accounting policies of the statement, refer to the Company's 2006 financial statement.

### (2) Enterprises merger

For the goodwill (equity investment difference) incurred from the merger of the controlled enterprises, the Company shall fully write off the equity investment difference not yet amortized prior to January 1, 2007, which totaled Rmb 351,890,262.71, and shall reduce the retained earnings by Rmb 351,887,893.25 and minority shareholders' equity by Rmb 2,369.46.

As the long-term deferred expenses due to the absorption and merger of Yichang Thin Plate and Baosteel Chemical are similar in nature to the goodwill (equity investment difference), the Company shall fully write off the equity investment difference not yet amortized prior to January 1, 2007, which totaled Rmb 266,959,295.67, and shall reduced its retained earnings.

(3) Financial assets and available-for-sale financial assets based on fair value measurement, whose changes are accounted into current profit and loss

Financial assets and available-for-sale financial assets based on fair value measurement, whose changes are accounted into current profit and loss consist mainly of various kinds of bonds, stocks and funds. The Company fixed the fair value of trading financial assets and available-for-sale financial assets on January 1, 2007 in accordance with the closing price of the last trading day in some related security stocks and the public notice on net asset value. Meanwhile, the Company shall take as the retained earnings the difference between the fair value and book value of the trading financial assets, which

totaled Rmb90,003,982.06, and take as the capital public reserve the difference between the fair value and book value of the available-for-sale financial assets, which totaled Rmb11,919,418.29. The increased shareholders' equity belonging to the parent company totaled Rmb62,189,380.96 and the increased minority shareholders' equity totaled Rmb39,734,019.39.

#### (4) Derivative financial instrument

The Company, following the fair value provided by the bank on January 1, 2007, fixes the trading financial assets of the derivative financial instrument not yet fixed in the balance sheet prior to January 1, 2007 to be Rmb 450,065.20, and the trading financial debt to be Rmb 9,170,958.85. It reduces its retained earnings by Rmb 8,927,923.64 and increases minority shareholders' equity by Rmb 207,029.99.

#### (5) Income tax

As the Company implements the new accounting standard to adjust financial assets and available-for-sale financial assets based on fair value measurement, whose changes are accounted into current profit and loss, and derivative financial instruments, it increases the deferred income tax assets by Rmb 3,026,416.42 and the deferred income tax debt by Rmb 33,026,158.25 and reduces the retained earnings by Rmb 14,874,423.84, capital reserve by Rmb 2,442,646.40, and minority shareholders' equity by Rmb 12,682,671.59.

As the Company implements the new accounting standard, it wrote off the deferred income tax assets of Rmb 92,437,063.15 of last year on January 1, 2007 and reduced the retained earnings correspondingly.

#### (6) Influence on minority shareholders' equity due to the abovementioned adjustments

As the Company implements the new accounting standard to adjust financial assets and available-for-sale financial assets based on fair value measurement, whose changes are accounted into current profit and loss, derivative financial instruments, and the equity investment difference and long-term amortized expenses and income tax in controlled enterprises, the influence on minority shareholders' equity totaled Rmb 27,256,008.33

#### (7) Changes in minority shareholders' equity due to the change of the scope of consolidation

The Group holds 62.1% of the equity of Baosteel Finance Co., Ltd. The management of the Company considers that the sales income, net profit, and total assets constitute no significant impact on the Group's finance and operational results and therefore cannot be included in the consolidation following the relevant regulations of the current accounting standard and are calculated by the equity method. Under the new accounting standard, the Company includes the finance company into the consolidation, increases the minority shareholders' equity by Rmb 316,233,075.03 and separately lists it in the equity of the consolidated balance sheet.

The Company holds 50% of the equity of the Baojin Enterprise Co., Ltd and it is a joint venture enterprise of the Company. Under the current accounting standard, the Company, in preparing the consolidated financial statement, consolidates the assets, debts, income, expenses and profits of the Baojin following the proportionate consolidation method. Under the new accounting standard, the Company does not include Baojin into the consolidation and it is calculated by the equity method instead. The minority shareholders' equity of the affiliated companies of Baojin, totaled Rmb 4,189,367.55, is not included in the Company's consolidated balance sheet, which causes a reduction of Rmb 4,189,367.55 in the minority shareholders' equity. Under the new accounting standard, the minority shareholders' equity is separately listed in the equity of the consolidated balance sheet and it therefore affects the shareholders' equity under the new accounting standard of January 1, 2007.

#### (8) Changes in the listing of minority shareholders' equity

After the aforementioned 6 adjustment, together with the minority shareholders' equity as listed in the financial statement already audited in 2006, the minority shareholders' equity totals Rmb 4,941,492,138.80. Under current accounting standard, debts and shareholders' equity are listed together in the consolidated balance sheet. Under the new accounting standard, equity is separately listed in the consolidated balance sheet.

## XI. Reference

- (1) The Financial statements have been signed and sealed by the Company's legal representative, Financial Controller and Chief Accountant.
- (2) The original auditors' reports have been sealed by the accounting firm with the signatures of the Certified Public Accountants.
- (3) Copies of the original company announcements, together with the relevant original company documents, have been published during the accounting period in newspapers designated by the China Securities Regulatory Commission.

Board of Directors,

Baoshan Iron & Steel Co., Ltd.

29th March 2007







