TWO YEAR HIGHLIGHTS OF OPERATING RESULTS

	2006	2005
(Millions of New Taiwan Dollars)		
Revenues	177,658	186,318
Operating costs	139,940	125,038
Income from operations	37,745	60,903
Income before income tax	47,679	65,112
Employment costs[1]	19,022	19,758
Depreciation	9,086	9,419
Interest expenses net[1]	198	194
Total assets	265,627	250,762
Capital expenditures	16,745	16,439
Stockholders' equity	203,533	196,626
(Thousands of metric tons)		
Output of steel products	9,945	9,698
Sales volume of steel products	10,225	9,804
Number of employees[2]	9,071	8,682
(%)		
Return on sales	26.84	34.95
Return on stockholders' equity[3]	19.57	26.60

[1] Excluding capitalized expenses
[2] As of the end of the calendar year
[3] Based on net income

Revenues and income before income tax

CHRONOLOGY OF MAJOR EVENTS

December 3, 1971	China Steel Corporation[4] is officially registered, with head office located in Taipei.
September 16, 1972	Kaohsiung Plant Site Office is established.
September 1, 1974	Phase I construction commences.
December 26, 1974	CSC stock is listed on Taiwan Stock Exchange.
September 15, 1975	Head office relocates to Kaohsiung. Plant Site Office closes.
July 1, 1977	CSC becomes a state enterprise.
December 16, 1977	Phase I is completed, with capacity[5] of 1.5 million tons[6] per year.
July 1, 1978	Phase II construction commences.
June 30, 1982	Phase II is completed. Capacity[4] reaches 3.25 million tons[6] per year.
July 1, 1984	Phase III construction commences.
April 30, 1988	Phase III is completed. Capacity[5] reaches 5.652 million tons[6] per year.
July 15, 1993	Phase IV construction commences.
April 12, 1995	CSC is privatized.
May 31, 1997	Phase IV is completed. Capacity[5] reaches 8.054 million tons[6] per year.
June 2, 1998	CSC Group's corporate identity system is formally introduced to the public.
October 7, 1998	Cumulative steel production[5] breaks the one hundred million ton[6] mark.
November 22, 2006	Groundbreaking for the CSC group headquarters building takes place.

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[4] Hereafter also referred to as the Corporation or CSC.
[5] In terms of crude steel.
[6] All references to "tons" mean metric tons of 1,000 kilograms.

A bird's eye view of China Steel Corporation

OVERVIEW OF THE BUSINESS SITUATION

Chairman and CEO Yao-Chung Chiang

President Yuan-Cheng Chen

Growth of world output in 2006 was 3.89% according to figures published in January 2007 by UN/DESA[7]. This is slightly better than the 3.5% of 2005. According to figures from the IMF in April 2007, the growth in 2006 was 5.4%, also exceeding 2005's 4.9%. Among individual countries and regions, the U.S. grew by 3.1%, the Eurodollar zone by 3.3%, the CIS by 7.7%, and the developing areas in Asia by 9.4%. China remained at the top of the world, having achieved a growth of 10.7%. As a whole the world economy showed overall steady growth, and the developing countries maintained a trend of higher economic growth. The DGBAS[8] of our government published the 2006 economic growth rate of our country as 4.62%, higher than the 4.13% of 2005.

As to the global steel market, prices in the European Union and the U.S. continued to rise until the fourth quarter before leveling off. China implemented austerity measures to its steel industry. Although production outgrew demand, prices continued to climb early in 2006. They underwent some downward adjustment in the third quarter, but rebounded to a stable level shortly afterwards. The IISI[9] statistics give the growth rate of global apparent consumption of finished steel in 2006 as 8.5%. Overall global steel demand was strong and steady, and Taiwan's apparent consumption of finished steel and steel prices were firm, with small increases every season.

On the domestic market, a number of adversities remain for the steel industry. They include:

- Outward moving of industries and the resulting restriction on domestic steel demand,
- Reduction of the import duty rate on steel to zero, causing the domestic steel industry to face direct competition with imports,
- Cross-strait relationship,
- The Kyoto Protocol limiting the quantity of CO_2 emission.

However, China's strong demand for high-end steels and the strengthened competitiveness of Taiwan's steel-consuming industries will lead Taiwan's steel industry toward positive development. Estimate by Taiwan Steel and Iron Industries Association indicates that growth in domestic apparent consumption of finished steel in 2006 was only 1.7%, and production among steel-consuming and steel-related industries fell short of expectations, but such a depressing situation can be reversed in 2007. As to the supply side, domestic production capacity increased by only an insignificant amount and steel supply in 2007 is expected to increase slightly.

Soaring iron ore and ferro-alloy prices plus the necessity to use large quantities of purchased slabs to fill in the hot metal shortage during the shutdown of No.2 blast furnace campaign revamp caused a sharp rise in the Corporation's raw material cost in 2006. The following countermeasures enabled the Corporation to turn in superb performance for 2006 nevertheless:

- Strengthen maintenance to ensure smooth production
- Actively proceed with the re-engineering of production and sales work flow
- Shorten the work flow
- Develop domestic manufacture of maintenance and repair parts to suppress the cost
- Raise yield
- Improve production facilities.

Total sales volume reached 10.23 million tons[6], which exceeded the 9.8 millions tons of 2005. However, revenues and income before income tax were NT$177.7 billion and 47.7 billion respectively. Both declined from their respective 2005 levels. Aside from the rise in raw material cost, which resulted in approximately 8% increase in average cost of sales per ton over 2005, another major cause of the declines was the roughly 9% drop in average price of steel in the same period. It is quite remarkable that profit performance in 2006 bettered by far the NT$31.0 billion forecast made late in 2005. Besides, non-operating income and gains of NT$9,660 million made a new record, and contributed substantially to the Corporation's profits.

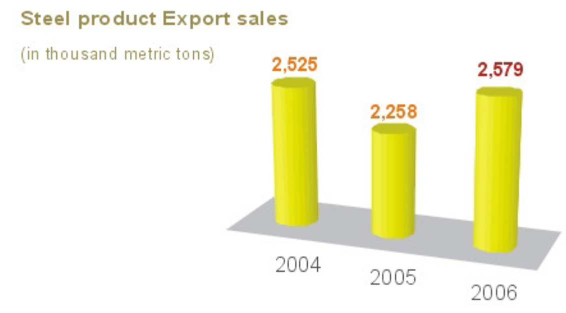
As to the outlook for 2007, UN/DESA forecasts a moderate growth rate of 3.2% for the world output, slightly inferior to that of 2006. The DGBAS[8] forecasts our country's economic growth rate to be 4.3%, a slight dip from 2006. IISI forecasts global apparent consumption of finished steel to grow by 5.9% in 2007. For major individual regions of steel consumption, Japan's rate of growth will exceed that of 2006. All the other regions (the EU, NAFTA, China and India) are expected to experience a decline from 2006. The cost of key materials (iron

Tapping operation at the blast furnace

PRODUCTION AND SALES

The Corporation sold 10.23 million tons of steel in 2006, up by 4.3% from the previous year. Domestic sales accounted for 74.8%, exports for the remaining 25.2%. Among the domestic customer groups, re-rollers again took the largest share (25%) of the domestic shipments. This group is followed by service centers (14.6%), nuts and bolts makers (8.2%), steel piping (8.1%) and direct users (7.6%). Among the export destinations, Northeast Asia and China (including Hong Kong) accounted for 36.6% and 35.1% of the export volume respectively, followed by Southeast Asia (21.7%) and other destinations (6.6%).

The 2006 production volumes for hot metal, liquid steel and steel products were 10.41 million, 11.06 million and 9.95 million tons, up by 960 thousand, 890 thousand and 250 thousand tons from 2005 respectively. Major reasons for the increased production were (1) No. 2 blast furnace, shut down in 2005 for campaign revamp, was back on line with an enlarged hearth. (2) Beginning January 2006 all-out effort was made to bring up production to meet the upturn in demand in a re-invigorated steel market. Previous records in annual production were broken in:



Basic oxygen steel making furnace

— No. 2 sinter plant
— No. 2 blast furnace
— No. 2 hot rolling mill
— bar and rod spheroidizing plant
— No. 1 pickling and cold rolling plant
— electro-galvanizing plant
— No. 1 hot dip galvanizing plant

With successive substantial hikes in 2004 and 2005, coal prices went out-of-line. Sustained increases in production brought the prices down in 2006. Percentage of price declines ranged from 13% to 35%. As to iron ore, prices also soared in 2004 and 2005. However producers had a grasp on production and sales. As a result price rises of fine and lump ore went unabated, by 19% in 2006 alone. Pellet price rises went overboard in 2005. So even with a 3% fall in 2006, pellet prices are still considered high. Prices of flux materials rose only by less than 5% in 2006 owing to stability in supply and demand.

To cope with the upward pressure on production cost in 2006 caused by soaring material prices, major directions of effort were:

— strengthen maintenance to avoid shut-downs and maintain smooth operation, thereby reducing the occurrence of repair expenses
— actively proceed with the re-engineering of production work flow and shorten the work flow to reduce cost.
— develop domestic manufacture of maintenance parts to reduce the cost of parts

ore, coking coal, coke, etc.) delivered to the steel works will see a moderate rise as a result of expected upward movement in ocean freight. The rampant consolidations among steel companies of the world, China's raising of its export duty for semi-finished steel products and lowering of import duty refunds for steel used for export — all help to cut down exports and lessen trade friction as well as uphold international steel prices. On the supply side, owing to the buoyant steel market over the past five years, shut-down of old and high marginal cost equipment has been delayed. Major steel companies of the world implement expansion plans one after another and engage in mergers and acquisitions to seek additional capacity. Particularly worthy of mention is the emergence and rapid development of China's steel industry, and its quick advancements in global ranking. In spite of adjustments and insignificant cutbacks in capacity, steel supply will remain higher than previous years.

In order to face competitors of increasingly large production capacity, the Corporation launched an investment of NT$200 billion in five years in the steel sector of the CSC Group, aiming to reach 20 million ton annual production capacity[10] for the Group.

The investment covers phases 1 and 2 of stage II[11] at Dragon Steel Corporation, and renewal and expansion of the wire rod plant and addition of a new cold rolling line at the Corporation's plant in Kaohsiung. Aside from reaching 20 million tons per year of production capacity, this investment will push upward the share of high grade and high end steels in the Corporation's product mix and raise the Corporation's competitive position.

Owing to the high energy-intensiveness of steel production, the new environment protection restrictions promulgated in many countries will directly impact the steel industry. This situation has caused the Corporation to develop and introduce energy saving and waste reducing technology and equipment, in order to:

- conserve energy
- reduce the generation and discharge of wastes
- recycle and reuse waste materials.

All the above aim at fulfilling the Corporation's duty as a corporate citizen.

Besides, the Corporation has in mind reinforcing the R&D capability of its downstream manufacturers and to raise the competitiveness of Taiwan's steelmaking and steel-related industries as a whole. Since 2004 the Corporation has joined the efforts from industry, government and the academia to form R&D alliances for the following steel-related trades, products or process technologies:

- automobile fasteners
- hydraulic forming of pipe and tube fittings
- hand tools and users of rods and bars
- high strength steels for automobiles and forming technologies
- electric motors.

Plans for the future include:

- continue to promote R&D cooperation for upgrading of products in the steel-related industries
- jointly nurture the key core technologies
- assist downstream steel consumers in their joint efforts to grow, upgrade, enlarge value-added, and
- create new values in the steel industry.

For future development the Corporation has clearly set its vision as:

> We aspire to be a trustworthy steel company of global distinction that pursues growth and value-innovation.

We have drawn up our operating direction for the forthcoming five years, with the operating direction for 2007 as:

- Launch our NT$200 billion investment program
  Toward 20 million ton annual production
- Faithfully implement our safety programs
- Protect our environment while reaping benefits from energy savings and waste reduction
- All-out R&D effort
- Upgrade ourselves as well as our customers.

This is the key to our mid- and long-term development. The entire workforce will be inspired toward this direction to further enhance the Corporation's performance and maintain its superb level of profitability.

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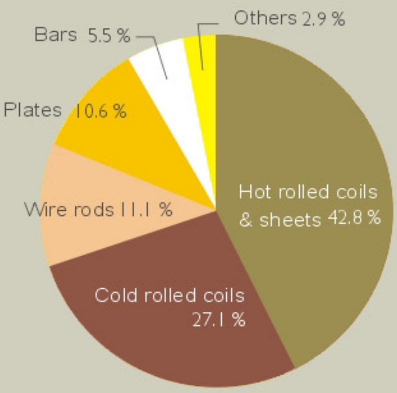
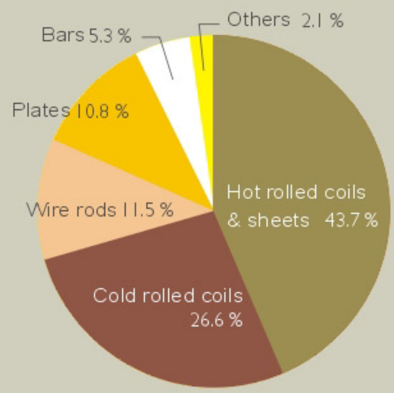
[7] Department of Economic and Social Affairs of the United Nations Secretariat
[8] Directorate General of Budget, Accounting, and Statistics
[9] International Iron and Steel Institute
[10] The Corporation dubs these two projects collectively as the "*Double 2000 Project*" because in the Chinese way of expressing large numbers, 200 billion is 2,000 *yi* (a *yi* stands for 100 million) and 20 million is 2,000 *wan* (a *wan* stands for 10 thousand).
[11] Stage I is the existing electric furnace and wide flange section mill.

Percentage of steel sales volume by product, 2006



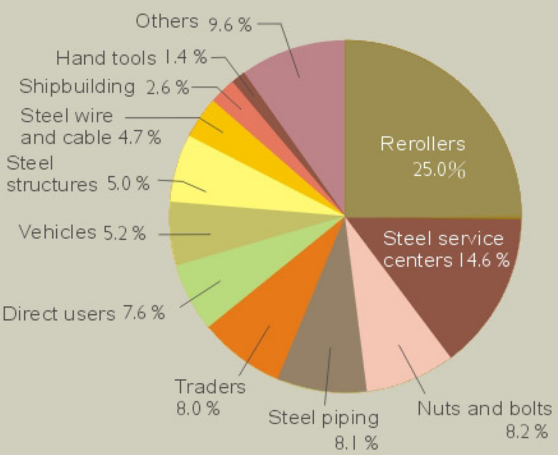
Total 10,225 thousand tons

Percentage of steel production volume by product, 2006



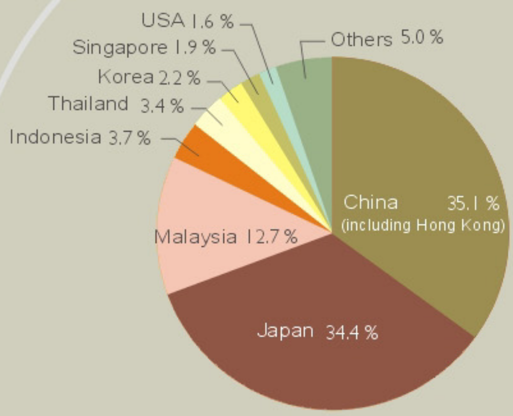
Total 9,945 thousand tons

Percentage of domestic sales by industry, 2006



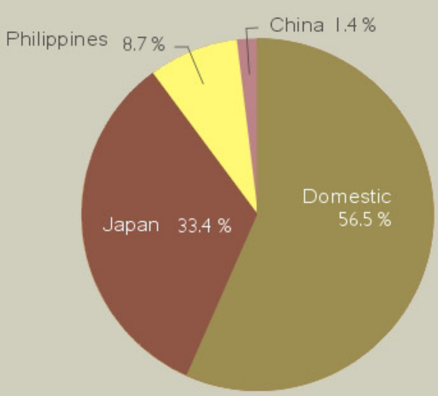
Total 7,646 thousand tons

Percentage of export by region, 2006



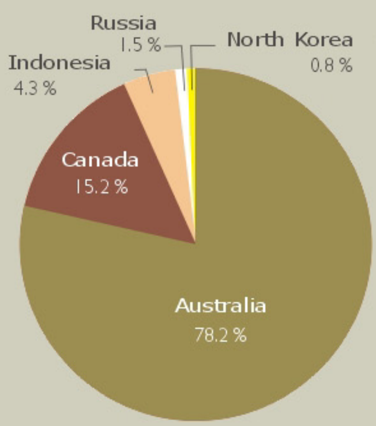
Total 2,580 thousand tons

Sources of flux materials, 2006



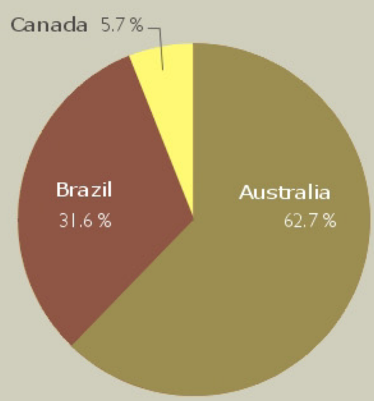
Total 3,167 thousand tons

Sources of coking coal, 2006



Total 8,414 thousand tons

Sources of iron ore, 2006



Total 16,163 thousand tons

Dioxins analysis laboratory

RESEARCH AND DEVELOPMENT (R&D)

Since 2005 the Corporation has added 30 outstanding researchers with doctoral degrees to its R&D team. At the same time it invested NT$2.5 billion to expand or replace its R&D facilities. This will help to augment its research human resources, facilitate the introduction of the latest core knowledge and to broaden as well as deepen its realm of research.

The Corporation has since 2006 gone all-out to promote the “Forward-looking Innovation Program” and “Upgrading Assistance to Downstream Users” as major endeavors in R&D. It hopes to, through its own sound corporate health, help the entire steel producing and steel-related industry to upgrade, thereby laying a solid foundation for the Corporation’s sustained operation and development.

In the past the Corporation’s R&D has centered on assistance in solving problems involved in production processes and products, and in product improvement to help the customers with their problems. In 2006 the Corporation brought up five “Forward-looking

Innovation Programs" covering three areas; namely, products, processes and equipment/environment/energy.

In the area of products, the program seeks to induce the Corporation's production departments to add new equipment so as to effectively raise the Corporation's share in the market for high value-added products. In the area of processes the program aims at establishing advanced process technology to raise the Corporation's process capability. In the area of equipment/environment/energy the program seeks to enable in-house manufacture of the advanced equipment and systems and to upgrade the Corporation's environmental performance to levels better than those required by law. All the above programs must have the research and development of foundation technology melded into them so as to establish a knowledge base for the outstanding development of the technology for each of the above areas. Therefore the "Forward-looking Innovation Programs" may be regarded as the most significant change in the Corporation's R&D over the past thirty years. The Corporation's direction of development will be guided by R&D. Together with the upstream and downstream entities the Corporation will develop new products, new processes and raise the competitiveness across the entire steel industry.

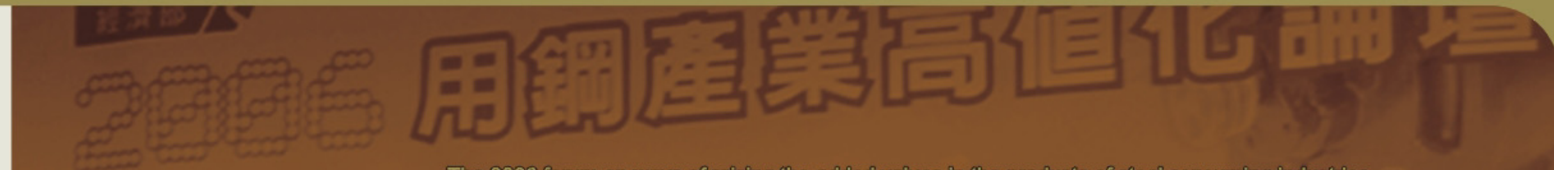
As to the "Upgrading Assistance to Downstream Users" program, work promoted includes:

— An "R&D Driving Office for Steel Industry Upgrading" was set up with the assistance of the Department of Industrial Technology, Ministry of Economic Affairs. This office is responsible for the actual promotional activities for the R&D.
— Within the Corporation, under the TQM committee, a Steel Industry Upgrade Promoting Committee has been established. Together with the MOEA Department of Industrial Technology, this committee engages outside experts and scholars to form a steering committee to jointly decide the implementing strategy for the Driving Office. The Driving Office executes the promotion with the collaboration of the Corporation's technology, commercial and corporate planning divisions, Gains Investment, downstream entities, the academia and research institutions.
— Plan and form R&D alliances. Integrate the resources of industry, government, academia and research institutions to identify the problems and opportunities in the industry and promote the actual work in R&D.
— Cooperate with the MIDC in classifying the steel-using industries into 21 categories, which are analyzed according to an order of priority determined on the basis of quantity of steel consumed, value of production, level of technology and each industry's future prospects. Up to the end of 2006 analyses have been carried out on the nut and bolt,

Launching the R&D alliance for advanced molding technology for automobile panels

Launching the R&D alliance for advanced high strength steels and for forming technology for automobile bodies

Launching the R&D alliance for integrating the technologies in the manufacture of high efficiency motors



The 2006 forum on ways of raising the added values in the products of steel consuming industries

hand tools (using bars and rods), automotive panels, automotive structure, motors, hand tools (using plates and sheets), and steel structure industries. Six R&D alliances have been set up.

In addition, the Corporation has made substantial R&D achievements in 2006 in process improvement, new product development and enlarging the share of high grade steels in the product mix.

In process improvement, principal items were:

— Hot test run of No. 2 ladle furnace of No. 1 steelmaking plant was completed and placed in operation, providing greater capability for combined refining process treatment.
— Nos. 4 and 6 vacuum treatment facilities, originally built together as adjoining units to share one vacuum system, were successfully remodeled by separating into two independent units. This remodeled facility is provided with vacuum treatment-powder blowing (RH-PB) function for desulfurization and opens the way for producing ultra low sulfur high grade steels. It also eliminates a treatment capacity bottleneck.
— Improved the equipment and process in the new spheroidizing annealing furnace, providing timely relief to the spheroidizing capacity problem.
— Completely worked out the most suitable product combination for lubrication rolling at the hot strip mill. This solved the problem of poor coil shape of hot rolled bands.
— Developed a new process to make it unnecessary to process 50CS400 electrical sheets through the pickling and oiling line (POL). This relieves the bottleneck at the POL and helps to achieve on-time delivery.
— To cope with the restrictions set by the EU in its "Restriction of Hazardous Substance Directive (RoHS)", the Corporation established the analysis technology of trace contents for four heavy metals: lead, cadmium, mercury and hexavalent chromium.

In the realm of new product development, items completed largely belong to high grade, high end products. They are expected to add 65,000 tons per year to the Corporation's order books for such products. They include:

— plates	steel for machinery structures SCM 440
— bars and rods	bearing steel SUJ2, low alloy free cutting steels SCM4XXSO/86XXSO, and pre-stressed concrete steel bars 32 SiB.
— hot rolled products	high strength automotive steels SAE J2340 550XLF, high carbon pickled and annealed tool steels SK 85 PA.
— cold rolled products	steels for precision press-shearing CB270TE
— coated and galvanized steels	automotive hot-dip galvanized sheets and 50 CS350 electrical sheets.

Signing of collective agreement with the China Steel Labor Union and of a "Partners for Safety" Declaration with the Council of Labor Affairs

EMPLOYEE RELATIONS AND HUMAN RESOURCE DEVELOPMENT

As of the end of 2006 the Corporation employs 9,071 persons. Average age is 48.2 years. 8,991 employees or 99.9% are eligible for membership in the China Steel Labor Union.

For the sake of clear written definition of the obligations and rights of labor and management, the Corporation has entered into a collective agreement with the China Steel Labor Union to specify fair and reasonable labor conditions for both sides to observe. Early in 2006, management and the union worked out an extension of the agreement that embodies a number of even more comprehensive terms that fit the contemporary environment. The extended agreement was ratified by both the Corporation's board of directors and union's Members Representative Meeting, signed in January 2006 and became effective on February 9, 2006.

To strengthen communication with employees the Corporation maintains multiple channels of dialogue. In addition it sets up a Committee for Handling Sexual Harassment at the Workplace to handle complaints and to provide employees and job applicants a workplace environment free of such disturbances.

Over the past few years the Corporation has engaged in improving the employee age

Employee's average age and years of service
(as of December 31, 2006)

Average age
Average years of service[12]

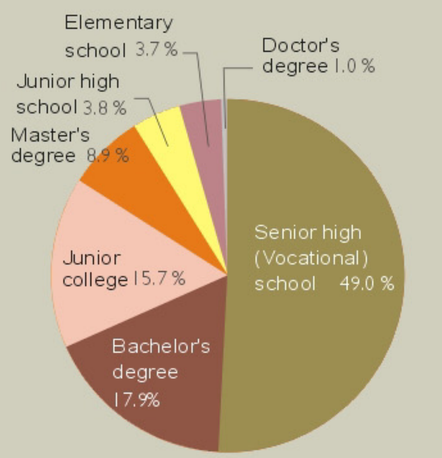
[12] Not counting years of employment prior to the privatization of the Corporation on April 12, 1995.

Number of employees
(as of December 31, 2006)

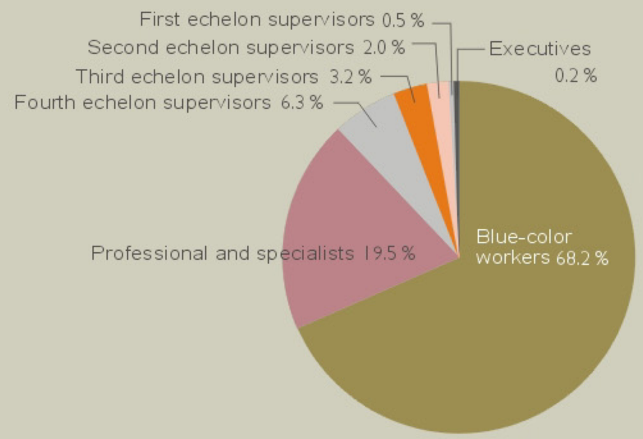
distribution and raising its vitality. It put into effect the Guideline for Employee Early Retirement Incentive Program (expires at the close of business on December 31, 2006). This program applies to qualified employees whose application has been approved by management. In addition to the standard pension settlement, an incentive extra payment is paid. The Corporation has in mind (1) to encourage employees with long years of service, and those with health problems that impair their capability, to retire early and (2) to introduce younger persons into the workforce, and thereby improve the human resource and age structure. In 2006 employees who opted for early retirement and those who reached retirement age numbered 181 and 76 respectively.

To cope with the increasing average age and the possibility of a surge of retirements, the Corporation has set up a Task Force for Plans of Maintaining Continuity in Human Resources with a view to recruit at the appropriate time new employees for key positions currently occupied by persons approaching retirement. The new employees will serve as apprentices to accept the handing down of key knowledge and technology. Such recruiting plans must be under the major premise of downsizing the workforce. The Corporation also pushes forward corporation-wide knowledge management to ensure effective handing down of key skills and technologies. At the same time the Corporation is planning the recruitment of a suitable number of new employees at an appropriate time to fill the manpower requirement of the Corporation's new product lines and support for Dragon Steel's expansion. New employees recruited in 2006 numbered 558. Besides, the Human Resource Department conducts periodic reviews with all the departments so that the workplace will be replenished with adequate number of new employees at the appropriate moment.

For the employees and management personnel (vice-presidents and above) the Corporation has set up "the Employees' Pension Fund Administration Committee" and "The Officers' Pension Fund Management Committee." The Corporation engages actuaries to compute the accrued pension liability, and regularly convenes supervisory and review meetings, so as to ensure the pension rights for employees and officers. As of the end of 2006, the employees' pension fund has a balance of NT$13.187 billion. Actuaries' computations indicate that the net pension costs for 2007 is NT$ 1,638 million. Beginning January 2007 the appropriation rate for pension fund (the current month's appropriation divided by total salary expenses for the month) was raised from 10.11% to 12.57%.



Educational background of employees, 2006
(as of December 31, 2006)



Breakdown by employees' position level, 2006
(as of December 31, 2006)

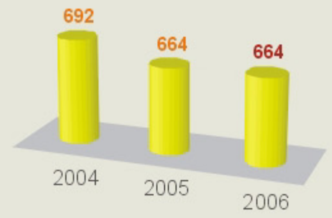
To establish an organizational vitality index, the Corporation conducts non-scheduled vitality surveys as a basis for improving employee satisfaction. Owing to the fact that the Corporation's compensation, fringe benefits, and training and development opportunities are among the best in the domestic job market, employee satisfaction has been high and turnover rate (new hires and separations divided by average number of employees expressed as percentage) relatively low. As 2006 is the last year of the Early Retirement Incentive Program, the large number of retirements caused the 2006 turnover to hit the record high rate of 8.5%. The next highest was 3.1% in 2005.

The Corporation has set up according to law Joint Committee for Employee Welfare[13]. Under this committee is the Welfare[13] Center to provide the employees and their families various services in food, clothing, housing, transportation and recreation. Beginning 2002 the Corporation began to conduct customer satisfaction surveys on the Center's services. Results indicate rising rate of satisfaction year after year.

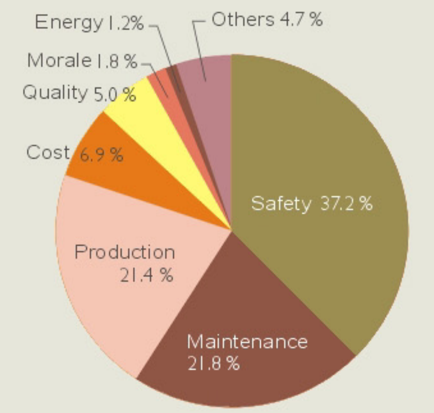
The Corporation follows the Labor Standards Law. Article 30 of the said law limits total working time to 84 hours over two weeks. Since two days off per week has gradually become the trend, the Corporation reached an agreement with the Labor Union to convert a number of national holidays to work days so that, with a forty-hour work week, employees do not have to come to work on a number of Saturdays to make up for the four hours per eight weeks. Thus two days off *every* week are ensured.

The Corporation regards human resources as a major asset. In order to attract top-notch talent, retain and make good use of such talent, the Corporation has drawn up a sound compensation system. Compensation consists of:

(1) basic salary
(2) production-sales profit bonus
(3) performance-based bonus
(4) year-end bonus
(5) compensation for unused leave of absence
(6) profit sharing bonus
(7) employee stock-purchase trust program.



Cases completed by Creative Development Activities



Cases completed by Creative Development Activities by subject matter, 2006

The levels of items (1), (2), (3), and (6) are closely linked to the personal performance of individuals and performance of the Corporation as a whole.

Corporation-wide training expenses amounted to NT$ 54 million. Classroom instruction and e-learning hours per person in 2006 averaged 34.2 and 3.1 respectively, or 91.7% and 8.3% of total training hours. The program of selecting promising employees for sending abroad to academic institutions or business organizations is aimed at consolidating the Corporation's capabilities in production, R&D, technology, management and further development of the employees' foreign language proficiency, as well as to meet the needs for manpower in CSC's diversification and globalization. In 2006 the Corporation sent 103 persons to academic and business organization for short-term studies or training in related subjects. It also enrolled promising employees in universities in Taiwan (17 person) and overseas (1 person) for advanced studies.

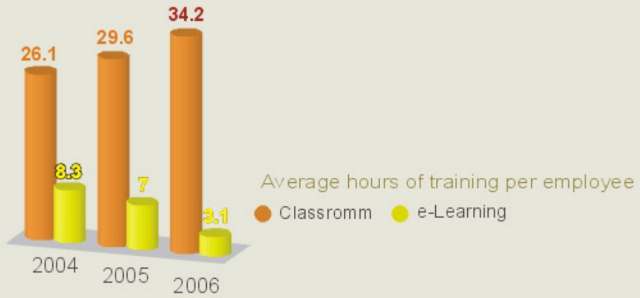
The Corporation formally launched the promotion of knowledge management in January 2003. Groups of first echelon units are successively brought into the project. To-date inventories for a knowledge data base and a talent pool have been completed. Careful evaluation by first echelon supervisors or general managers has produced a talent pool of

2006 Presentation of accomplishments in knowledge management over 800 persons who qualify as instructors. These people are professionals in the technology of steelmaking. In addition, in order to enhance the effective utilization of the knowledge and talent data bases, an on-line knowledge management system has been developed under the assistance of professional vendors to accelerate the completion of the Corporation's integrated knowledge network, and to continue the preparation of the e-learning curricula.

The Corporation's knowledge management promotion program has won the nomination for Asia's MAKE (Most Admired Knowledge Enterprise) award for three consecutive years. In 2005 its integration of e-learning and knowledge management received the "Award for Outstanding e-Learning System from the Ministry of Economic Affairs and recognition from the Council of Labor Affairs in the First Annual National Group Award for Human Resource Innovation."

The Corporation filed applications in three successive years (2003, 2004, 2005) to the National Science Council (NSC) for designation of its "CSC Group's Build-up of e-HRD" (human resource development) as a special project[14] and succeeded in all three years to receive top recognition and financial awards. The Corporation's e-learning management system has been one step further integrated with the knowledge management system when it introduced the competence management and individual development program (IDP) functions. As to the source of digital curriculum material, it will primarily be prepared in-house, contracted out or purchased as a package. In order to promote in-house and contracting out preparation, the Corporation invited outside experts to lecture on the general

Recruiting new employees



concept of e-learning, the use of the preparation tools, and the planning of the curriculum contents. The Corporation also undertook the cultivation of 800 in-house curriculum preparation experts and completed more than 400 e-learning curricula. The demand for curriculum preparation primarily follows the results from the inventory taking of key technical competence of the knowledge management program. Instructors are drawn from the expert talent database. Thus knowledge management and e-learning can be closely joined together to enhance the accumulation and growth of the Corporation's human capital.

The time-honored suggestion system and Creative Development Activities (CDA) in the Corporation aim at encouraging employees to offer constructive suggestions and to discover and solve problems at the workplace through teamwork and group endeavor. In 2006, 587 CDA activity circles with 5,119 participants (89.8% of the blue-collar employees in the departments involved) completed 664 topics, with total benefit exceeding NT$90 million. As for the suggestion system, the Corporation took note of 23, 205 suggestions and adopted 22,278, or 96% of them. Tangible benefits from these suggestions exceeded NT$130 million.

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[13] fringe benefits

[14] This NSC program of designation and financial awards is a five-year program, to be terminated in 2007. After having been honored with top recognition for the first three successive years of this five-year program, the Corporation elected to refrain from applying in 2006.

A performance put on by the Christian Mountain Children's Home of Liouguei Village at the Corporation's 35th anniversary celebration in 2006[15]

ENVIRONMENTAL PROTECTION, INDUSTRIAL SAFETY AND HYGIENE, AND FULFILLMENT OF SOCIAL RESPONSIBILITIES

To enhance the effectiveness of the Corporation's industrial safety and environmental protection, the Board of Directors adopted a resolution in December 2006 to separate the Industrial Safety, Hygiene and Environmental Protection Department into two departments: Industrial Safety and Hygiene, and Environmental Protection. Both are first echelon departments and remain under the Production Division. This change takes effect in January 1, 2007.

The Corporation continues its efforts in environmental protection and in raising the safety consciousness among its employees and the personnel of the outside contractors. 2006 was designated the "Safety and Environment Year." The Corporation also signed a "Partners for Safety" Declaration with the Council of Labor Affairs. Under the concept of "Respect for lives. It's the people that really matters," the Corporation assumes a responsible attitude to care for the well-being of its people by cultivating a superior culture of industrial safety. It hopes to reach in two years zero lethal occupational accidents among employees and contractor personnel, and to lower the disabling accidents frequency ratio by 40%. In addition the Corporation undertakes 13 projects including (1) plant-wide work safety and hygiene examination, (2) job safety demonstration and (3) adjustments in the industrial safety organization. Progress and results are satisfactory, particularly the safety organization adjustments that assigns to each production department's general superintendent a staff of two to three persons for safety and hygiene planning. This in effect puts the management of safety and hygiene of each production line under the department itself. The reorganization also enables each of the two separated departments (safety and environment) to turn their effort on the forward looking studies of the Corporation's long-term safety and hygiene and environmental protection agenda.

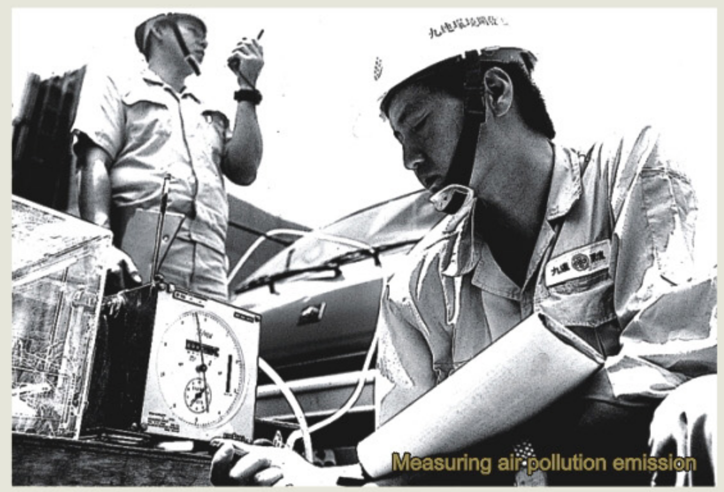
Environmental Protection and Industrial Safety and Hygiene

The Corporation's safety and hygiene and environmental protection activities and accomplishments include:

– completed numerous items of computerization of environmental protection and continued the development to further improve the effectiveness of the related management systems.
– through the Traffic Safety Subcommittee, provided 37 solutions for problems at hazardous locations, thereby substantially reduced the occurrence of traffic accidents in the plant.
– arrange for physical examinations according to regulations and according to the specific nature of the employee's duties. The Corporation will refer to the results to carry out follow-up activities. At the same time the Corporation invites experts to study the results together with data of the employee's working environment to grasp the hazardous factors and carry out preventive education and training to avert latent occupational diseases.
– proceed with studies on pollution-resistant plant species to serve as basis for determining the plant-wide effectiveness in CO_2 reduction and the selection of trees for expanded greening and beautifying of the plant premises.

Ocuupational accident record of CSC - past three years

Number of cases with disabling injuries



Measuring air pollution emission

— plan the establishment of environmental accounting following the trend at home and abroad. Completion of establishment is expected by the end of 2007.

Activities in prevention of air pollution and waste water management include:

— completed the examining of stacks for particulates, SO_x, NO_x, volatile organic compounds and dioxin. The results have been declared. Approvals, or extensions thereof, have been obtained according to law for CSC's processes and for the operation of the related stacks, as well as the changes, installation, operation and moving of the stacks. At the same time, effectively operate, manage and maintain the monitoring equipment (continuous emission monitoring system, closed circuit TV, and ambient air quality monitoring system) in order to ensure normal operation.

— proceed with the countermeasures to the proposal from environmental protection organizations to impose a levy on volatile organic compound emissions and the local government's restriction on dioxin emission from sinter plants.

— establish an inventory and management system for greenhouse gases and study the strategy to manage greenhouse gas emission to cope with the worldwide trend to restrict such emissions.

— monitor the progress of the various projects to improve the hardware at the sources of pollution, and install closed circuit TV on-line monitoring. Arrange for periodic and non-periodic on-site patrols. One of the targets of such patrols is to safeguard effectively against kish emission.

— ensure the normal operation of waste water treatment facilities and continued checking of the quality of effluent wastewater in order to reduce the burden on the water environment.

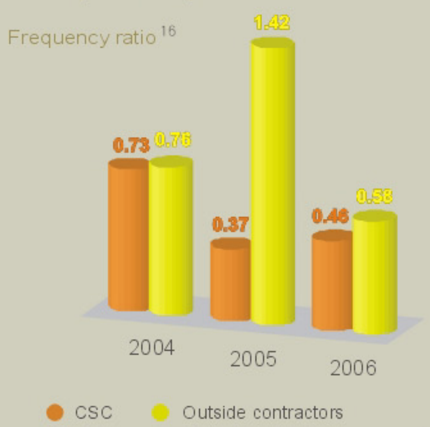
— strengthen the management of storm wastewater drainage system.

— continue to manage the operation involving toxic chemicals. Proceed with soil and groundwater pollution investigation and monitoring on all owned and leased land.

Since 2000 the Corporation began promoting the Occupational Health and Safety Management System (OHSAS 18001) and received the certification of British Standards Institute in April 2002. With more than four years of actual operation and of continual improvement, CSC has upgraded its safety and hygiene performance. Accidents resulting in disabling injuries dropped from 23 cases in 2000 to nine in 2006. Such accidents among contractors' workers dropped from 24 cases to nine in 2006. In 2006 disabling injuries to CSC and to contactors' personnel were 9 and 10 cases respectively. They were largely due to unsafe behavior. Type of the accidents was principally falling (42%), six of which occurred to contractor's personnel. Among the 142 cases of non-conformance discovered in the 2006 audits, those under system reviews 4.4.6 "operational control" and 4.3.1 "hazard identification, risk assessment and control" accounted for 38.7% and 31.7% respectively. This phenomenon is related to the cause for the disabling injuries, and will be a point of emphasis in future measures for strengthening safety and hygiene supervision.


Plant greenery

Occupational accident record of CSC - past three years



[16] FR = Number of cases with disabling injuries × 10^6 / Total number of working hours of the entire company

The Corporation will continue to promote the various operational controls of OHSAS 18001, spread the corrective and preventive measures plant-wide and will invite blue collar employees and contractors' employees to participate in revising the Safe Job procedures so that they conform to the actual working conditions. At the same time CSC will establish work and equipment safety standards to ensure the intrinsic safety of the facilities.

In the realm of waste recycling, in order to elevate the value-added of the recycled waste and the efficiency of such activities, CSC is an active participant in seminars for resource recycling technology. At the same time it joins government authorities, experts and scholars and members of the waste transportation and treatment business in discussions on recycling technology, management, laws and regulations. Specifically CSC promotes the development of high value-added uses of basic oxygen furnace slag as aggregate for asphalt concrete and as an additive in reinforced concrete. It also assists member companies of the CSC Group who engage in turning byproducts into resources. It continues the recycling of tar sludge from China Steel Chemical Corporation, dust and oil-containing waste water from the secondary smelting at C.S. Aluminum Corporation, waste oil from China Express Corporation's ships, waste acid from China Steel Machinery Corporation, and Chung Hong Steel Corporation and crystalline calcite from China Ecotek Corporation's operation of a drinking water supply plant under contract.

As to air quality, CSC's emission of air pollutants, particulate pollutants, sulfur oxides and nitrogen oxides have all shown marked declines, and are in compliance with the upper limit of total emission CSC committed to during the environment impact assessment (EIA) prior to CSC's launching of phase IV expansion; namely, particulates 20,000 kg/day, SO_x 35,000 kg/day, NO_x 35,000 kg/day. Besides, emission per ton of crude steel also showed improvement: in 2006 it is 0.47 kg particulate, 0.99 kg SO_x and 0.97 kg NO_x.

As to water quality, three reservoirs in CSC's plant store a total of 160,000 tons of water, all of which originates from the Fong-shan Reservoir. The water is supplied by the Fong-shan water treatment plant of the Taiwan Water Supply Corporation. The city water from the reservoirs is treated with slaked lime to remove the temporary calcium hardness and sent to the points of consumption through the plant-wide treated water piping system. Daily consumption of raw water is about 165,000 tons. To ensure stable supply, a joint exercise (the water company, Taipower and CSC) is held each year to simulate situations requiring emergency water supply.

Over the years the Corporation follows the principle "reduce water usage and reduce waste; reclaim, recycle and reuse; and multiple reuse." Through project engineering, Creative Development Activities and the suggestion system, CSC has raised the efficiency of water resource usage. Consumption has fallen from 10.33 cubic meters per ton of crude steel in the early years of operation to 5.37 in 2006. Currently circulation of cooling water plant-wide amounts to 6.85 million CMD, with rate of recovery exceeding 97%. Such outstanding water-saving achievements have won for the Corporation the annual "Water Conservation Outstanding Performance Award" four times from the Water Resource Agency of the Ministry of Economic Affairs.

In 2006 the Corporation began planning the increase of crude steel capacity to 12 million tons per year, with a higher ratio of high grade products and successive addition of new production lines. It is estimated that these measures will call for an additional 27,500 tons of water per day. To cope with this forecasted situation, the Corporation is studying the feasibility of the following projects or measures so that the demand for water from the water company remains at its present level.

— improve the quality of treated water. The remodeling of the north side clarifier is expected to be completed by June 2007 at which time the yearly average calcium hardness of treated water will drop from 155 ppm to 120ppm. This will reduce raw water consumptive by about 7,500 CMD. Completion of remodeling of the south side clarifier is expected to reduce the consumption further by 2,500 CMD.
— recycle effluent wastewater: Membrane filtration technology will be used. Preliminary plans call for the recycling of 13,500 CMD at the completion of stage 1 by 2009. Implementation of stage 2 will depend on the demand for de-mineralized water. Ultimate target of such recycling is 18,000~21,000 CMD.
— recycling of rain water: Facilities will be planned together with the improvement on plant buildings or expansion of production lines.
— recycling of storm waste water: Feasibility is being studied.


Dust collecting equipment for the blast furnace

Average quality of effluent in 2006: COD 39.7 mg/L, suspended solids (S.S.) 5.98 mg/L, both far lower than the national regulation of effluent standards of COD $<$ 100 mg/L and S.S. $<$ 30 mg/L. After the completion of the above projects, the effluents will be reduced by 13,500 ~ 21,000 CMD. Under the major premises of stable effluent quality, this will substantially reduce the total quantity of effluents.

In order to cope with world-wide trend in environmental protection as it is related to greenhouse gases and climate change, CSC actively promotes the reduction and management of greenhouse gases and plans the strategy for such measures, including evaluation of the impact from regulations and the market situation, capacity building of software and hardware, inventory and verification, voluntary reduction, technology development and international activities. At the same time numerous action plans are drawn up to achieve the strategic targets. Projects in progress include: inventory of greenhouse gases, voluntary reduction requested by Ministry of Economic Affairs, regional integration of energy resources, 2010 energy saving plan, and training programs of energy saving service force and related capacity building of software and hardware. Voluntary inventory taking in 2006 and 2006 gives these results on CO_2 emissions: 21,782,000 tons and 23,038,000 tons respectively, and CO_2 emission per ton of crude steel for 2005 and 2006 was 2.21 tons and 2.15 tons respectively. Gases emitted include CO_2, methane, N_2O and hydro-fluorocarbons, of which CO_2, which results from the use of energy, accounts for by far the largest share: 99.7% in 2005. Largest source of such emission is coal, 88.4% followed by flux material 5.3%, purchase electricity 4.6% and others 1.7%.

Over the years the Corporation has invested in and made improvements on pollution control facilities on the raw material conveyors, coke batteries, sintering plants, blast furnaces and BOF furnaces. Nevertheless equipment disorders or unexpected events still cause fugitive dust occurrences. Occasionally the authorities may assume a more rigid attitude in enforcing the regulations, making it inevitable for CSC to be subject to complaints and be fined. Number of pollution "tickets" received in 2004, 2005 and 2006 was 7, 15 and 17


Water reservoir

respectively. Facing increasingly strict regulations, CSC has no choice but to step up environmental auditing, review and amend its operating standards, and ensure that the standards comply with the government's regulations.

The Corporation has for years injected substantial manpower, materiel and financial resources to achieve sustained operation and development. In order to reach the target of zero pollution and sustained utilization of resources, CSC will continue to follow its environment management concept: "continual improvement and pollution prevention." strengthen operation control and equipment improvement. In the area of operation control, CSC will amend or add to the operation and maintenance specifications of the equipment at the pollution sources and pollution prevention equipment; and through the administrative channels demand all related personnel to follow faithfully so as to avoid human errors and cause pollution emission. In the area of equipment improvement, each production department will be asked to make a general review to determine all the source points that may generate pollution, to set targets of improvement as basis for drawing up and proceeding with various economically feasible environment management plans.

Accomplishments in 2006 were:

Reduction in emission of particulates	12 tons/year
Energy saving benefits	NT$390 million/year
Converting blast furnace slag into a resource	
(water-quenched slag as raw material for cement)	100%
Recycling of sludge	100%
Recycling used refractory	100%
Proper treatment of hazardous and non-hazardous wastes	100%

Air Quality

[15] The Children's Home lost its principal access road when the old bridge across the Laonong River was destroyed by typhoon flood in 2004. A new steel bridge, donated by the Corporation, now provides safe means of transportation for the children.

The Corporation's choir

Corporate Social Responsibilities

To be a good corporate citizen and fulfill its social responsibilities, the Corporation has over the years committed to itself a corporate image based on "excellence, growth, integrity and responsibility." It pays all the taxes as required by law. In 2006 it paid a total of NT$9,786 million, of which NT$344 million were local taxes and NT$9,442 million were national taxes. It implements various environmental protections and industrial safety measures under the concept of "continual improvement" and is not satisfied with merely the compliance with the laws and regulations. Through the environment/ safety management system the Corporation keeps up with all the changes in the industrial safety and environment regulations and requirements, and study as well as carry out the measures to comply with the changes. CSC strives to lower the risks of accidents and impact on the environment as well as to maintain close dialogue with the regulating authorities, experts and scholars to absorb experience and understand the trend of problems plus the related tools and technology. For example, the measures to cope with problems concerning CO_2 greenhouse gas and prevention of injuries from dioxins have all been established according to the above model and achieved remarkable results and recognition from the regulating authorities and the public.

The Corporation has for many years been concerned about the development of the place where it is domiciled. CSC maintains sound relationship with neighboring communities and pursues its "good neighbor" programs. For years it has helped the public primary and middle schools in the Siaogang District to augment their educational facilities. It establishes scholarships for outstanding students and financial assistance to students from low income families, and offers gifts to such families on the occasion of the three festivals[17]. It assists local communities to greenify and beautify surroundings, refurbish local community centers and actively participates in festivities, religious festivities, local folklore and philanthropic activities. It holds open-house of the plant to the local residents, holds ceremonies for the recognition of exemplary devotion to parents, and plant tours for the students from the local primary schools.

Jointly with the community, schools and Kaohsiung City Symphony Orchestra, the Corporation held a series of musical events including the "Mozart Gala" in April 2006, "A Night with Tango", "250 Viva Amadeus Mozart" and a CSC choir performance in December

Voluntary Inrentory of Greenhouse Gas Emission

2006. These events offer to the residents of Siaokang musical festivities and enjoyment and at the same time inject a bit of artistic and cultural vitality to the City of Kaohsiung.

In November 2006, to further expand and implement actions to fulfill its responsibilities as a corporate citizen the Corporation established the CSC Group Education Foundation. The foundation will formally begin its operation on January 1, 2007. Its aims and purposes are:

- to promote and to nurture talent in realms related to steel
- to care about the conservation of the ecosystem
- to raise the spirit of humanities
- to pursue sustained development.

The foundation will engage in the following activities pursuant to laws and regulations:

- enlarge the utilization of steel and the relevant promotional education activities
- encourage and assist the related technical research and nurture talent in related fields
- public benefit activities such as the conservation of the ecosystem and care for sustained development and
- promote educational activities in art and culture
- other public benefic and educational affairs that conform with the foundation's aims and purposes.

In the future the Corporation will follow the concept of “what is received from society should be used for society’s benefit” and continue to show concern for society, community and the disadvantaged by its concrete measures in environmental protection, outreach programs, and public benefit activities.

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[17] Dragon Boat Festival, Moon Festival and Lunar New Year

Blow-in ceremony of the third campaign of No. 2 blast furnace

CAPITAL EXPENDITURES AND ENGINEERING BUSINESS

Thirty-three project type capital expenditures were in progress in 2006, involving disbursements of NT$12.018 billion.

I. Related to equipment revamping

1. revamp of billet reheating furnace of No. 1 bar mill at Rolling Mill Department I.
2. No. 2 blast furnaces second campaign revamp
3. revamp of Nos. 1 and 2 sinter plants
4. end flue repairs for coke oven batteries 1 and 2
5. replacing Nos. 1 and 2 ship unloaders
6. replacing electrical equipment on the leveler at the plate mill
7. revamp of No. 1 continuous annealing machine

II. Related to production capacity increase or quality upgrade

8. addition of coal bins for coke oven batteries 3 and 4
9. addition of vertical and horizontal stands on the billet mill and revamp of electrical equipment

10. addition of second ladle refining furnace at No. 1 steel-making plant
11. revamp and remodeling of Nos. 4 and 5 continuous slab casters
12. addition of a fourth hot stove for No. 1 blast furnace
13. addition of unit No. 9 at the oxygen plant
14. addition of No.2 continuous hot-dip galvanizing line
15. remodeling and rebuilding of Nos. 4 and 6 vacuum treatment facilities into two independent refining stations at No. 2 steel-making plant
16. addition of Nos. 6 and 7 lime kilns for the steel-making plant
17. addition of residual material treatment plant
18. modification of No. 4 basic oxygen furnace to coject process system
19. No. 2 main transformer station expansion
20. addition of No. 2 annealing and coating line
21. addition of coal moisture control system for coke batteries 1 through 4
22. addition of No.7 continuous slab caster
23. revamp of raw material ship unloading conveyor system
24. expansion of pallet width and revamp of No. 3 sintering plant
25. addition of edge heater for No. 1 hot strip mill

III. Related to resource recycling

26. addition of coke dry quenching equipment for coke batteries 7 and 8
27. addition of waste heat recovery system for hot stoves on No. 2 blast furnace
28. addition of waste heat recovery system for hot stoves on No. 4 blast furnace

1 Diamond turnout for Kaohsiung Rapid Transit rail system
2 Car hoist and body stand for Kaohsiung Rapid Transit's South Depot
3 Tunnel track work for Kaohsiung Rapid Transit rail system

Blast furnaces Nos. 1 ~ 4

Continuous ship unloader

IV. Related to re-engineering of business process and enhancing competitiveness

29. Supply chain management (SCM) software for integrating sales and production

V. Related to land and buildings

30. construction of CSC Group's headquarters
31. land purchase from Kaohsiung Irrigation Association
32. land purchase from Lone Star Asset Management Company III. Ltd.
33. land purchase from Ruey Shiang Steel Enterprise Co., Ltd.

Items 24, 25, 31, 32 and 34 are projects begun in 2006. The remaining items are continuation projects. Items completed in 2006 are as follows:

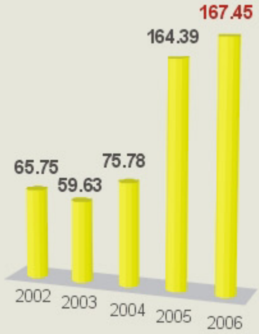
Item	Completion
1, 15	March
3, 8	April
2, 10, 11	June
26	July
12, 27	October
9	December
31, 32, 33	Purchase transaction completed in March, July and October

Item 18 was terminated because the equipment supplier could not agree to the reasonable guarantee terms requested by CSC and negotiations broke off.

All the remaining items are proceeding according to plan.

Individual projects with investment exceeding NT$3,000 million are items 2, 14, 20 and 22. Expected increases in annual capacity after their completion are:

Item 2	350,000 tons hot metal
Item 14	120,000 tons galvannealed (GA) steel products and 180,000 tons galvanized iron (GI) products
Item 20	200,000 tons high grade non-oriented electrical sheets
Item 22	550,000 tons liquid steel



Capital expenditures
(in hundred millions of New Taiwan Dollars)

Non-project type capital expenditures in 2006 amounted to NT$4.727 billion. Their objectives are related largely to equipment replacement, industrial safety and environmental protection, re-engineering of business process, quality upgrade, R&D, energy saving, automation and miscellaneous facilities necessary for the operation.

The Corporation was awarded by Dragon Steel Corporation the contract for engineering services for Dragon Steel's phase 1 of stage II expansion. Ceremonies for signing of equipment purchase and groundbreaking were held on July 21, 2006. Work commenced on the same day for civil engineering construction for the pier and the major items of equipment. As of the end of 2006, cumulative progress was 14.99%, ahead of planned schedule. The blast furnace is expected to be blown in on December 1, 2009, and increase CSC Group's capacity by 2.5 million tons of hot metal per year. Besides, CSC will assist Dragon Steel to proceed with its phase 2 of stage II expansion. Environment impact assessment (EIA) for phase 2 is being reviewed by the Environmental Protection Administration.

Beginning 2003 the Corporation has been awarded a series of contracts by Kaohsiung Rapid Transit Corporation including track work construction, AC power supply system, depot equipment, structure corrosion online monitoring system, and track maintenance vehicles. Work on these contracts is proceeding on schedule.

Opening the Kaohsiung Rapid Transit for "preview" rides

SUBSIDIARIES AND OTHER EQUITY INTERESTS

In 2006 the Corporation made investments in two additional companies, Baolai Greeting Development and Hsin Hsin Cement, making a total of 40 companies with CSC investments. Since many of them made good profits and record earnings, they contributed substantially to CSC's 2006 investment income by an amount of NT$9.661 billion.

Steel business

Since Chung Hung Steel recognized according to generally accepted accounting principles a "loss for market price decline—materials" in 2005, its carrying raw material cost early in 2006 was relatively low. A timely upturn in steel price pushed up its gross profit. Pretax income for 2006 was NT$5.801 billion, a record high for Chung Hung. Dragon Steel Corporation adjusted upward its H section prices and turned to high priced market for a portion of its products. It also achieved record high pretax income of NT$1.910 billion. Ornasteel and Group Steel in Malaysia together posted and pretax income of RM82.81 million, which is an improvement over 2005.

Logistics and trading

Owing to hovering high freight rates, favorable chartering-out terms and good scheduling, 2006 pretax income was NT$4.413 billion, also a record high. China Steel Global Trading achieved a pretax income of NT$428 million. It played a key role in 2006 in developing the market and business opportunities for products from CSC's new production lines.

Industrial materials

C. S. Aluminum faced the rise in aluminum ingots by skillful adjustments of its aluminum ingot purchases so that its material inventory cost in book value was benefited by a favorable price differential. Pretax income was NT$1.049 billion. Income and production and sales volumes all recorded new highs. China Steel Chemicals Corporation benefited from the hovering high oil prices. Its prices went up and so did its pretax income: NT$1.514 billion, a record high. Smooth sales of pulverized blast furnace slag and a breakthrough in its problem of seeking waste treatment sites enabled the business of China Hi-ment Corporation to grow and post a pretax income of NT$831 million.

Engineering and construction business

Continued improvement in business operations and strict cost control have enabled China Steel Machinery Corporation to achieve a pretax income of NT$251 million, a record high since the company became a member of the CSC Group. China Ecotek Corporation's pretax income was NT$221 million owing to new orders that are more profitable. China Steel Structure Co. made good use of its advantages in fabrication capacity and financial status in its all-out effort competing for larger volume contracts that require quick delivery. Such contracts yielded reasonable prices. Furthermore CSSC's investment income was quite remarkable, helping to boost CSSC's pretax income to NT$251 million, showing an improvement over 2005.

Finance and service businesses

Many of Gains Investment Corporation's investees become listed and their stock prices went up. As a result Gains Investment Corporation reaped substantial gains from the stock market, and registered a record high pretax income of NT$1.055 billion for 2006. China Steel Security Corporation's profitability continued to improve owing to economy of scale as its number of security system customers broke the 4,000 mark. Profitability has been improving gradually. Its pretax income for 2006 amounted to NT$44.51 million. Info-Champ Systems Corporation maintained stable operations with pretax income of NT$117 million.

1. Christening ceremony of M.V. China Steel Team at CSBC Corporation, Taiwan
2. Groundbreaking ceremony of CSC group headquarters building
3. Groundbreaking for integrated steel mill at Dragon Steel Corporation

Business development

For the steel sector the Corporation's major objectives are to bring the Group's annual capacity to 20 million tons of steel products, with an investment of NT$200 billion in five years. It will make all-out effort to assist Dragon Steel Corporation to complete its stage II phase 1 expansion and to push forward the construction of the second blast furnace at Dragon Steel as its stage II phase 2 development. CSC expects to raise the upstream capacity of hot metal and liquid steel within the Group as well as the overall competitiveness of the Group's steel sector. Besides, in order to build up a more stable relationship overseas as a supplier of steel, China Steel Global Trading Corporation is actively setting up a network of sales channels. It has invested in a number of downstream companies overseas to expand its capability to market the Group's steel products.

As to the non-steel sectors, the Corporation will periodically evaluate the earning capability of the investees, study the route to maximize benefits, and prudently select those investment opportunities of high inter-relationship with steel business and of high potential for development.

CUSTOMERS AND SERVICES

The Corporation is customer-service-oriented. For years the Corporation keeps reminding its employees of the maxim: "Customers are the ones who feed us and clothe us." Through the "Upstream-downstream system" and the periodic "Sales-Production Confab[18]" CSC joins itself (the upstream) with the customers (the downstream) through a symbiotic relationship. It has an accurate understanding of the customers' demand status and provides them with steel of the right quality and quantity at the right time as well as helps them solve their problems of steel application. In effect CSC has advanced one step further from quality guarantee: it offers application guarantee. It goes all-out in carrying out measures to enhance customer relationship, and in simplifying the relevant procedures so that the Corporation becomes the customers' favorite. These measures include:

- hold production/sales meetings each quarter with the trade associations to which the customers belong[18]
- price of CSC products follows international levels to make sure that the customers remain competitive worldwide
- implement the "price reduction retroactive rebates[19]"
- develop new high grade products to meet the customer's demand. In this way both CSC and the customer enjoy the benefits of product upgrade.
- promote the use of e-purchasing among customers. In 2006 customers' e-purchasing orders accounted for 92.59% of CSC's sales.
- hold non-periodic seminars on technical and commercial subjects.
- incessantly seek self-development and assist customers to update their knowledge on steel materials
- regular visits to customers by CSC sales personnel and their supervisors
- through the application of e-commerce and the introduction of a supply chain system, offer the customers entire packages of information in response to their inquiries.
- conduct a "customer satisfaction survey" every year performed by members of the academia to guide CSC in improving customer service.

The Corporation has for years adopted sales development strategies in the form of reasonable prices, solid and stable channels, new product development, and fortified customer service.

1. reasonable prices. Reasonable prices accompanied by the mechanism of "price reduction retroactive rebates[19]"
2. favorable prices for major direct users (such as automobiles, home appliances) and discuss long-term supply agreements.
3. favorable prices for new products and customers who cooperate with CSC in the development of such products.

- consolidate channels
  1. Priority in supplying those customers who (a) use high grade and high value-added steel products, (b) enjoy advantage in global competition, (c) have potential for future development, (d) participate in R&D alliances or business cooperation, and (e) are investment-wise related to CSC and whose development directions parallel those of CSC.
  2. Combine CSC's, Chung Hung's and Dragon Steel's marketing resources in support of one another to enlarge the scope of customer services.
  3. Actively seek opportunities to invest in downstream steel plants or steel consuming industries to consolidate relations with the customers.
  4. Utilize the accomplishments of R&D alliances to join together the upstream and downstream supply chain systems.

- develop products
  1. install additional production line for high value-added downstream products to increase the proportion of high value-added products in the Corporation's product mix.
  2. give priority to developing high grade and green products with market potential.
  3. develop and provide customized products, with the cooperation of the customer.
  4. maintain CSC's high quality image, establish global renown for the CSC trade mark.
  5. for products successfully developed with the cooperation of a customer, CSC may give the cooperating customer sole right to order the product for a period of time depending on circumstances.

— fortify customer service

1. establish a total solution service mechanism which may be considered a “value added service sector” of the steel industry.
2. offer the customer total solutions to his problems.

CSC’s customers may be classified according to the CSC product they consume as follows:

I. Plate

Largely concentrated in shipbuilding, steel structures and trading, followed by machinery, engineering, pipes, pressure vessels. Major customers in the shipbuilding trade are CSBC Corporation, Taiwan and private shipyards. The steel structure business consists of the large domestic structure fabricators. Traders play the role of supply channels, and their plate business is largely to supply the structure fabricators.

II. Bars and Rods

Users are largely from the nut and bolt, wire and cable, hand tools, automobiles and motor-cycles, and welding rod industries. Owing to low prices and high quality, CSC’s bar and rod products have long since become the backstop of Taiwan’s small and medium businesses in their efforts to gain a foothold in foreign markets.

III. Hot Rolled Products

Re-rollers make up the largest group of customers, primarily using this product as input material for their downstream cold rolling and hot-dip galvanizing lines. Yieh Phui, Sheng Yu, Kao Hsing Chang, Chung Hung, Ton Yi Industrial all rely on CSC as the principal source of hot rolled products. Other users include pipe and tube makers, steel service centers and vehicle makers.

IV. Cold Rolled Products

CSC product largely goes to steel service centers. Other customer groups who rely on CSC as their main source of materials are in drum making, electro-galvanizing, automobiles, pipes and tubes, home appliances, furniture and hardware. Particularly worthy of mention is that CSC’s CQ2 cold rolled products have won wide acclaim from customers.

V. Electrical Sheets

Major uses are in motors and transformers. Aside from the large domestic appliance makers, other customer groups are the punching plants and service centers.

VI. Electro-galvanized Products

Major use has shifted from computer shells to LCD TV backlight units and frames. This product is largely processed by steel service centers and shipped to LCD TV on module makers.

VII. Hot-dip Galvanized Products

Principal uses are in automobiles, home appliances, construction materials, and pre-painted galvanized iron (PPGI). For galvannealed sheets used in automobiles bodies CSC is the only producer in Taiwan.

Beginning 1996 the Corporation engages the academia to conduct each year a satisfaction survey among domestic customers. The results are collated and sent to the related departments in the Corporation to conduct a review and make improvements on those points that customers emphasize in their replies. The 2006 survey report is expected to be completed in May 2007. The 2005 survey covered sales, pricing, quality, customer service, communication, delivery, transportation, e-commerce service. Subjects with top three highest ratings were (1) providing good quality products, (2) clarity of invoices and accounts and (3) dimensional accuracy of products; while subjects with the bottom three ratings were (1) the gap between CSC’s prices and international price levels, (2) level of CSC product prices and (3) ability of CSC’s prices to reflect the current market transaction price level within Taiwan. Overall satisfactory rating rose gradually from 63.1 in 1996 to 70.16. From a long-term view there is a trend of gradual improvement.

Items of CSC’s customer service and accomplishments in 2006 include:

— Technical services

This is under the responsibility of the Technical Services Section— Metallurgy. For each product there is a technical service engineer and a senior engineer to provide consultation for the metallurgical and processing problems brought up by the customer. The service group also accepts customers’ complaints related to metallurgical problems and the requests for compensation. After sampling, analyzing and certifying CSC’s responsibility, CSC routes the relevant information to CSC’s quality control personnel and the production department for improvement. Alternatively CSC may guide the customer into selecting the appropriate material. Numerous sessions of technical seminars are held and special phone lines are provided to handle customer complaints and inquiries.

— Financing services

With the bank interest rate level as reference, CSC provides each quarter a favorable rate for usance credit for the customer to select and utilize. In order to enlarge the customer’s credit allowance, CSC introduces e-commerce L/C and e-negotiation to shorten the processing time, and offers the facility of e-factoring with an insurance system to reduce CSC's account receivable risks. Besides, CSC joins with the Credit Insurance Fund for Small and Medium Enterprises to offer a line of "Firefly" credit, thus providing the domestic small and medium industry with a financing alternative. Also to expedite payments to customers (rebates, compensations, etc.), CSC begins in 2006 to adopt the Financial Electronic Data Exchange (FEDI) and absorbs the expenses. Such measures further exemplify CSC's care for its customers.

— Sales services

CSC's Marketing Department is composed of four sections, each for a particular line of product. For domestic customers, CSC personnel in each section is responsible for the procedures of price quotation, contract signing, specifying the product, quantity, delivery, payment, shipment, and for closing the case. For export customers, China Steel Global Trading Corporation and its correspondent trading companies overseas are delegated by CSC to serve the customers.

— Sales support services and electronic commerce

In order to provide more convenient instant support service, CSC develops e-commerce support services for the customers to make inquiries on the status of the order, production, storage, shipping, loading, and discounts, and to download the above information as well as the invoice, shipping documents and mill certificates. This service is provided free of charge.

CSC further promotes the use of e-commerce on a number of info-logistics services: L/C opening, negotiation, invoicing, inland transportation, and order entry and changes. In 2006 after the introduction of supply chain demand collaboration and forecast system, CSC links the customer's demand with CSC's production capacity so as to provide even more exact arrangements for time of shipment.

— Day to day service by telecommunication

Questions on specifications, steel selection and processing technology may be handled on the telephone, fax and e-mail.

— Service before sales

1. Visits to major customers according to set plan. In 2006, 70 visits were made to review the benefits from continual quality improvement, to grasp the direction of development of the industry to which the customer belongs, and to discover potential demands.
2. To gain an understanding of transformations in the foreign market and to strengthen technical services to oversea customers, 165 man-days were spent on trips to India, Italy, U.S.A., Japan, Korea, Hong Kong and China.
3. Technical seminars

   CSC held nine seminars, which benefited 1,001 attendees.

   (1) Principally to follow the trend of development in industry. The themes of the seminars are closely related to the promotion of CSC products. For instance, in response to the government's call to increase the production value of automobile parts and components, CSC held two technical seminars in 2006 related to the selection and processing of steel materials for automobiles.

   (2) CSC holds Conference on Engineering and Technology for Steel over the past 20 years straight.

   (3) Both the practical usefulness of the discussion (or instruction material) and the quality of supporting arrangements have won the satisfaction of the attendees at all the sessions.

   (4) Percentage of technical service performed on CSC's initiative, in terms of number of days, rose from less than 50 % of total amount of service performed in the past to 70% in the last two years.

— After-sale service

1. Handling of customer complaints

   Complaints and requests for compensation are immediately routed to the sales personnel or supervisor. They visit the customer to gain an understanding of the problem and provide an explanation. Through the venue of the quarterly meetings with the trade association to which the complaining customer belongs, CSC conducts face-to-face communication and exchange of ideas with the customer. Meanwhile the case should be satisfactorily settled. Concrete records of results of CSC's handling of complaints are: (1) Aside from settling customer complaints in a reasonable and just manner, CSC considers it more important to improve. Rate of complaint showed a year by year declining trend from the 2,600 ppm[20] of the early days. The rate in 2006 showed a very slight upturn to 870 ppm[19] owing to factors caused by the economy. (2) Emphasis on the speed of handling the complaints. More than 98% of the cases can be settled within 14 days.

   To facilitate the management and follow-up of complaints, the CSC sales webpage contains a steel complaint handling system. Customers may lodge quality complaints through this system.

2. Cases of improvement of customers' processes and material application technology numbered 96 in 2006.

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[18] Organized in the early days by customers' trade or product, e.g. "Nut and Bolt Makers' confab." These confabs gradually evolve into meetings between CSC and the various trade associations to which the customers belong, such as the Steel Wire and Wire Rope Association.

[19] Price reductions for any given quarter are applicable retroactively to the orders placed during the previous quarter. The difference is rebated.

[20] Total tons of steel products involved in all the cases of complaint settled as CSC's responsibility during the year, per million tons of steel products shipped during that year.

RISK MANAGEMENT

In addition to emphasis on the prevention of occupational accidents, CSC effectively identifies and analyzes the risk factors from raw material supplier and customer dependency, fund operation and others. It adopts various safety measures and takes out various types of insurance to safeguard the Corporation's properties and the safety of its workforce to avert the losses brought about by natural disasters and manmade calamities.

Stable raw material supply

Problems at the mines and loading ports or along the connecting railroad may cause interruption of supply. CSC adopts the following countermeasures:

— sign long-term agreements with numerous suppliers
— include as far as possible buyer's option quantities in all the agreements so that when one or more supplier fails to make shipment, CSC may exercise the option(s) with others to make up the shortage.
— actively develop new material sources to avoid oligopoly by a few suppliers.
— honor the agreement in good faith and build up good relations of mutual trust with all the suppliers.
— select good material sources as targets for investment. If evaluation proves positive, proceed with the investment to secure a long-term source of raw materials.

Customer dependency

To ensure regularity in the customers' taking delivery of the goods ordered, CSC helps customers to increase their bank credit facility and, together with banks, factor account receivables. Using the electronic business technology and the digital verification technique, CSC simplifies the procedures for customers to make payment. It keeps a close watch to ensure faultless operation of electronic technology and security mechanisms. Results of these measures: CSC has further improved the satisfaction of customers for its services, enhanced the customers' loyalty to CSC, accomplished a closely linked upstream and downstream supply chain system, and unifies the steel industry to cope with the future challenges and difficulties.

Fund operation

In addition to forecasting the occurrence of large receipts and disbursements, CSC keeps close watch on the daily balance of NT$/foreign currency and keeps up its alertness for hot line news around the world.

CSC manages its interest rate and foreign exchange rate fluctuations by means of dynamic control. Different measures are applied depending on the nature of the risks.

In times of stable exchange rates, natural hedge is applied. When exchange rate fluctuations are large and the trend is clear, CSC applies flexible adjustments to its foreign currency position, and centralizes its foreign currency position control to facilitate matching with foreign currency fund demand and to enable flexibility in converting positions between strong and week currencies, thus raising fund operation efficiency. In the event of a foreign currency demand gap, (mainly US$) CSC hedges exchange rate risks with forward foreign exchange.

Floating interest rate debt must be controlled with clear interest rate risk tolerances. When interest rates in the financial market turn around, CSC applies repayment prior to the expiry or interest rate swaps to convert to fixed rates.

Types of insurance

CSC regularly carries the following types of insurance:

— fire insurance and business interruption insurance
  Covers property losses and business interruption losses caused by accidents.
— erection insurance
  Covers physical loss or damage of erection works at the construction site that require replacement or repair, and bodily injuries or death and (or) property losses of third parties caused by sudden unforeseen accidents.
— public liability insurance
  Covers liability for third party's death, bodily injury and property loss caused by accidents from CSC's business activity or equipment.
— employer liability insurance
  Covers liability of employee's bodily injury or death caused by accidents while carrying out his duties.
— directors and officers liability insurance
  Covers liability on the part of directors, supervisors, officers (or the Corporation) for compensation to third parties owing to damages caused by inappropriate behavior of the insured while carry out his (their) duties.
— fidelity guarantee insurance
  Covers the Corporation's losses caused by criminal acts committed by the named employees.

CORPORATE GOVERNANCE

Ever since the Corporation was incorporated in 1971, it has looked upon its corporate values of teamwork, entrepreneurial approach, down-to-earthness and pursuit of innovation as the cornerstone of its corporate culture. Later on it added integrity and transparency to these values, and declared its insistence on the highest standards of governance. It has placed on the shoulders of the management team the following responsibilities:

— form a clear corporate vision
— carefully map out operation strategies
— effectively oversee the execution of the strategies
— raise the Corporation's power to compete and level of performance
— maximize the Corporation's profits to share with the Corporation's shareholders, customers, employees and other stakeholders.

Particularly worthy of mention is that facing the enormous group of more than 600,000 shareholders, the Corporation publicizes in a timely manner all the required relevant information. CSC's impressive performance protects the shareholders' interests and enables the winning of shareholders' trust. It strengthens their confidence so as to attract long-term capital and favorable impression from foreign investors.

Demography of the Corporation's shareholders and percentage of holdings:

domestic natural persons and juridical persons	69.71%
oversea juridical persons, natural persons, trust funds and investment (including global depository shares)	29.80%
government (public) institutions	22.66%
securities trust funds	4.14%
domestic financial institutions	3.69%

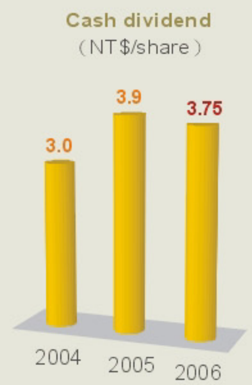
CSC has over the years established a sound system in corporate governance and has reaped good results. However, for the sake of further fortifying its governance, the Board of Directors adopted at meetings on December 20, 2005 and March 21, 2006 resolutions for the following important regulations:

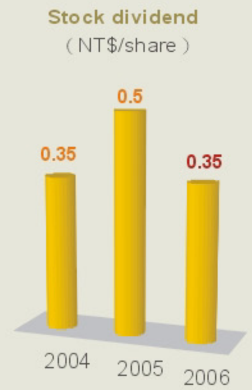
— Rules for the conduct of meetings of the Board of Directors

Clearly specifies that directors' assistants may attend the meetings, but only as observers. The rules also cover : (1) directors' compliance with the principle of avoidance in the event of conflict of interest, (2) requirement for related persons to protect confidentiality, (3) news releases, and (4) designation of managerial personnel for reporting on company status and for briefing and expounding of proposals at Board Meetings so that the directors may acquire an in-depth understanding, thereby raising the efficiency of the meetings and quality of the decisions.

— Code of Ethics for Directors and Supervisors

This regulation stipulates that directors and supervisors are obligated to act with due care and diligence when carrying out their duties in the best interest of all shareholders. Apart from that, competitive behavior (holding the same or similar positions in different companies engaged in the same or similar business) should be duly constrained, confidentiality should be safeguarded and insider trading prevented so as to avoid conflict of interest and improper advantages or profits through one's position.





— Code of Ethics for the First-echelon Managers and Executives

This regulation state that the upper-echelon (first-echelon and above) executives should avoid conflicts of interests. Specifically they should (1) resolutely shun private gains, (2) protect business confidentiality, (3) follow fair trade practices, (4) protect and properly utilize company property and (5) prevent insider trading. Honesty and professionalism should be the guidelines in meeting their obligations to the Corporation. Relevant disciplinary measures and the like for violations should be established.

— Amend the Corporation's organization chart to place the Internal Auditor's Office directly under the Board of Directors

The Internal Auditor makes periodic reports to the Corporate Supervisors on the auditing activities and attends the Board meetings as an observer.

— Amend the Articles of Incorporation to establish independent directors

The 2006 Regular Annual Stockholders' Meeting resolved to amend the Articles of Incorporation to provide for three independent directors. This amendment is to take effect beginning with the 13th Board of Directors to be elected at the 2007 Regular Annual Stockholders' Meeting. Besides, the three Corporate Supervisors, beginning in 2006, will meet semi-annually to hear a report duly audited and certified by the Corporation's independent accountants on the financial results.

CSC's corporate website contains a corporate governance district and stockholder service part. The former discloses the Board members' profiles, rules governing the conduct of Board meetings, major resolutions of the Board, organization and practice of internal auditing, codes of ethics, the Corporation's Articles of Incorporation and profiles of the management team. The latter discloses monthly operation and profit status and CSC stock prices. Annual reports presented at Annual Stockholders' Meeting and Manual for the Conduct of Stockholders' Meeting may also be downloaded. These measures make it convenient for stockholders to peruse the documents.

Transparency and equality of access to information form the consistent policy of the Corporation in communicating with investors. In addition to the disclosures required by law, CSC issues monthly self-compiled statements on revenues and pretax income to enable investors to fully understand the Corporation's status. To facilitate two-way communication CSC designates stockholder service personnel to answer queries from domestic and foreign investors, or to receive visiting investors. It conducts institutional investor conferences both in Taiwan and abroad. Owing to increasingly wide dispersal of stockholders and increase in holdings by foreign investors, transparency and equality of access to information become all the more important. CSC has the following measures to enhance communications with investors:

— toll-free stockholder service telephone line. This phone number appears in CSC's corporate website. Specially designated personnel are available to answer questions.

— transmission of material information by the Internet including the monthly operating results (not yet audited) and the quarterly domestic price adjustments. All this information is transmitted instantly to security analysts and investors by electronic mail.

— designate specific personnel to receive visiting investors and to be responsible for conducting plant tours and answering questions. CSC management actively participates in investor workshop conferences.

Information regarding transactions with related parties is disclosed by the Corporation in notes to the financial statement in conformity with Statement of Financial Accounting Standards N0. 6 "Disclosure of Related Party Transactions".

In order to concentrate the Corporation's efforts on its core business, and to maximize the benefits to the stockholders, CSC has applied, to an appropriate extent, constraint to investments in non-steel businesses by stipulating in its Articles of Incorporation that its total investments in other companies should not exceed the Corporation's paid-in capital. Among such investments, those made in non-steel-related companies should not exceed 20% of the Corporation's paid-in capital. Owing to CSC's concentration on the core business, and continued improvement of operating performance, profits over the past years have been attractive. Its dividend payout ratio has been maintained at above 80%, resulting in acclaim from the enormous number of stockholders, and stands as witness to the success of our pursuit of corporate governance.

CHINA STEEL CORPORAION ORGANIZATION CHART

(Effective from January 1, 2007)

DIRECTORS AND SUPERVISORS

(as of December 31, 2006)

Chairman of the Board	Yao-Chung Chiang	Representing Ministry of Economic Affairs, R. O. C.
Director	Yu-Po Cheng	Representing Ministry of Economic Affairs, R. O. C.
Director	Jung-Chiou Hwang	Representing Ministry of Economic Affairs, R. O. C.
Director	Ying-Yuan Lee	Representing Bureau of Labour Insurance
Director	Yuan-Cheng Chen	Representing Chiun Yu Investment Corporation
Director	Cheng-I Weng	Representing Gau Ruei Investment Corporation
Director	Iuan-Yuan Lu	Representing Ever Wealthy International Corporation
Director	Shun-Tsai Wu	Representing China Steel Labor Union
Director	Lo-Min Chung	Representing Chung Hung Steel Corporation
Director	Pyng-Yeong Liang	Representing Hsing Loong Investment & Development Co., Ltd.
Director	Ho-Chong Chen	Representing TS Investment Development Inc.
Supervisor	Chen-Cheng Huang	Representing Ministry of Economic Affairs, R. O. C.
Supervisor	Wang-Ping Gu	Representing Ministry of Economic Affairs, R. O. C.
Supervisor	Benny T. Hu	Representing Dragon Steel Corporation

SENIOR MANAGEMENT

(as of December 31, 2006)

Chairman of the Board and Chief Executive Officer	Yao-Chung Chiang
President	Yuan-Cheng Chen
Executive Vice President (Concurrently Spokesman for the Corporation)	Lo-Min Chung
Vice President - Administration	Chao-Tung Wong
Vice President - Commercial	Tzer-Haw Chen
Vice President - Finance	King-Hsing Chang
Vice President - Corporate Planning	King-Ling Du
Vice President - Technology	Yu-Soong Chen
Vice President - Production	Chaur-Hwa Ou

FIVE YEAR SUMMARY OF SELECTED FINANCIAL DATA AND OPERATING RESULTS

(in thousands of New Taiwan Dollars unless otherwise noted)

	2006	2005	2004	2003	2002
Revenues	**177,658,233**	186,317,669	168,270,036	129,702,797	99,939,846
Operating costs	**134,216,258**	125,037,400	110,249,399	88,991,768	79,566,230
Gross profit	**43,441,975**	67,325,877	63,958,975	45,998,550	24,828,036
(Realized) Unrealized gain on intercompany transactions	**(26,208)**	376,905	3,890	2,826	-
Operating expenses	**5,723,455**	6,045,608	5,938,338	5,287,521	4,454,420
Operating income	**37,744,728**	60,903,364	58,016,747	40,708,203	20,373,616
Net non-operating income	**9,934,025**	4,209,065	7,005,267	4,398,686	322,198
Income before income tax	**47,678,753**	65,112,429	65,022,014	45,106,889	20,695,814
Net income	**39,158,584**	50,646,639	51,616,691	36,979,214	16,839,080
Current assets	**75,046,154**	75,851,757	85,093,446	69,040,716	47,581,405
Long-term investments	**74,731,278**	65,881,813	50,631,972	44,558,206	35,532,286
Net properties	**110,453,314**	105,567,044	99,334,963	102,717,268	107,471,096
Other assets	**5,395,949**	3,461,726	3,348,613	4,354,529	4,857,546
Total assets	**265,626,695**	250,762,340	238,408,994	220,670,719	195,442,333
Current liabilities	**38,928,520**	45,109,246	33,673,946	34,350,984	27,026,296
Long-term liabilities	**17,126,250**	2,769,030	12,861,200	17,225,300	25,050,000
Reserve for land value increment tax	**2,171,124**	2,171,124	3,370,813	3,370,813	3,370,813
Other liabilities	**3,867,629**	4,086,449	4,341,921	4,686,838	4,989,828
Total liabilities	**62,093,523**	54,135,849	54,247,880	59,633,935	60,436,937
Capital stock	**110,944,516**	105,866,716	99,311,138	95,000,857	93,157,609
Capital surplus	**1,548,370**	2,744,741	1,172,320	693,047	481,597
Retained earnings	**83,429,463**	90,107,602	85,642,418	66,934,700	44,960,063
Cumulative translation ajustments	**(62,787)**	(335,992)	(365,599)	91,700	222,391
Unrealized loss on investees' long-term investments	**(37,358)**	(466,483)	(454,039)	(485,104)	(555,491)
Investees' unrecognized net loss on pension cost	**7,533,737**	(36,872)	(32,003)	(21,711)	(15,696)
Unrealized gain (loss) on financial instruments	**1,512,123**	1,535,363	339,174	339,174	339,174
Treasury stock [21]	**(1,334,892)**	(1,273,221)	(1,113,121)	(1,176,705)	(3,245,077)
Total stockholders' equity	**203,533,172**	196,626,491	184,161,114	161,036,784	135,005,396
Total liabilities and stockholders' equity	**265,626,695**	250,762,340	238,408,994	220,670,719	195,442,333
Stockholders' equity per common share (NT$)	**18.35**	18.57	18.54	16.95	14.49
Earnings per common share (NT$)	**3.56**	4.83	5.26	3.94	1.86
Earnings per common share (NT$) [22]	**3.56**	4.83	4.93	3.54	1.65

[21] Effective 2002, the Corporation's shares acquired and held by subsidiaries are accounted for as treasury stocks.

[22] After making retroactive adjustments on the number of common shares to take into account stock dividends.

FIVE YEAR SUMMARY OF SELECTED FINANCIAL RATIOS AND PERCENTAGES

	2006	2005	2004	2003	2002
Current ratio (%)	192.78	168.15	252.70	200.99	176.06
Ratio of fixed assets to long-term liabilities and stockholders' equity (%)	50.06	52.94	50.42	57.62	67.15
Total liabilities to stockholders' equity	0.31	0.28	0.29	0.37	0.45
Net income rate (%)	22.62	27.18	30.67	28.51	16.85
Profitability in terms of total assets (%)	15.32	20.93	22.80	18.27	9.38
Profitability in terms of stockholders' equity (%)	19.57	26.60	29.91	24.98	12.87
Revenue growth rate, year to year (%)	(4.65)	10.73	29.74	29.78	17.44
Stockholders' equity growth rate, year to year (%)	3.51	6.77	14.36	19.28	6.60

ANALYSIS OF FINANCIAL STATUS AND OPERATING RESULTS

1. Two-year analysis of flow ratios

	December 31, 2006	December 31, 2005	Increase (Decrease)
Cash flow ratio (%)	122	109	12
Appropriate cash flow ratio (%)[23]	117	119	(2)
Cash reinvestment ratio (%)	1.65	2.45	(33)

[23] Based on data over the past five years.

Analysis of changes in above ratios

(1) Increase of cash flow ratio from the previous year by 12% is mainly attributed to the repayment in 2006 of 2005's "bonds payable – current portion."

(2) Decrease in appropriate cash flow ratio from the previous year by 2% is mainly attributed to the slight increase of total distributed cash dividend over the five year period 2002-2006 with the five years period 2001- 2005.

(3) Decrease in cash reinvestment ratio from the previous year by 33% is mainly attributed to the increase in distributed cash dividend and decrease in net income.

2. Analysis of operation results

(1) The decrease of NT$23,883,902 thousand in gross profit is mainly attributed to lower steel prices and higher raw material costs in 2006 than in 2005. The effects on the current year's revenues and cost of revenues were a 5% reduction and a 13% increase respectively. As a result gross revenues decreased by 35%.

(2) The positive amount of NT$403,113 thousand in "(realized) unrealized gain on inter-company transactions" is mainly attributed to the Corporation's downstream sales to investee companies appearing as a net realized gain for the current period.

(3) The reduction of NT$ 23,158,636 thousand from the previous year in income from operations is mainly attributed to the same cause as (1) above.

(4) The increase of NT$4,453,264 thousand in non-operating income and gains over the previous period is mainly attributed to the increase in "investment income under the equity method."

(5) The reduction of NT$1,271,696 thousand from the previous year in non-operating expenses and losses is mainly attributed to the decrease in "impairment loss on financial assets carried at cost."

(6) The reduction of NT$17,433,676 in income before income tax from the previous year is attributed to the same causes as (1).

(7) The reduction of NT$11,488,055 thousand in net income is attributed to the same cause as (1).

TERMS AND CONDITIONS OF CORPORATE BONDS

Issue	Unsecured Corporate Bond	Unsecured Corporate Bond
Issue Date	From June 27, 2006 to June 27, 2011	From November 28, 2006 to November 28, 2011
Face Amount	NT$1,000,000	NT$1,000,000
Issuing Price	Coupon rate	Coupon rate
Amount	NT$8,100 ,000,000	NT$5,600,000,000
Coupon	2.32%	2.07%
Maturity	Five years (due from June 27, 2006 to June 27, 2011)	Five years (November 28, 2006 to November 28, 2011)
Trustee	Mega International Commercial Bank Head Office－Trust Department	Hua Nan Commercial Bank Head Office－Trust Department
Lead Manager	None	None
Legal Advisor to the Issuer	Chien Yeh Law Offices	Chien Yeh Law Offices
Auditor of the Issuer	Deloitte & Touche (A member firm of Deloitte Touche Tohmatsu）	Deloitte & Touche (A member firm of Deloitte Touche Tohmatsu）
Repayment	100% on maturity, interest shall be paid annually against interest coupon commencing from the issue date.	100% on maturity, interest shall be paid annually against interest coupon commencing from the issue date.
Rating Institution	Taiwan Ratings Corporation August 25, 2006 twAAA	Taiwan Ratings Corporation October 11, 2006 twAAA

PREFERRED STOCKS

Items \ Issuance date	Nov. 18, 1974	Jan. 31, 1980	Nov. 30, 1980	Dec. 31, 1981	Dec. 31, 2006
Face value (NT$)	10	10	10	10	-
Issuing price (NT$)	10	10	10	10	-
Number of shares	50,000,000	21,887,000	797,000	4,000,600	-
Total amount (NT$)	500,000,000	218,870,000	7,970,000	40,006,000	-
Unretrieved balance (shares)	500,000,000	71,887,000	72,684,000	76,690,000	40,694,000

Rights and liabilities	Appropriation of residual property	Same as that those of common shareholders.
	Voting rights	No right to vote in the elections of board directors or supervisors.
	Dividend policy	After all the accounts are settled, taxes paid, deficits offset, and the legal reserve appropriated, the remaining earnings will be distributed as follows: (1) Preferred stock dividends at 14% of the par value. (2) Remunerations to directors and supervisors of the board at 0.3% of the distributable earnings, 3%-5% as bonuses to CSC employees. (3) Common stock dividends at 14% of the par value. (4) The rest of the remaining earnings will be appropriated proportionally to the preferred stockholders and common stockholders as bonuses.
	Others	Other rights and obligations are the same as those of the common shareholders.
Preferred stock in circulation	Retrieved / converted shares	4,000 shares (year 2006)
	Unretrieved / unconverted shares	40,694,000 shares
	Retrieving or converting clause	The Corporation may retrieve the preferred stock using earnings or the proceeds from share issuance. Preferred shareholders have the right to convert preferred shares into common shares.

MARKET PRICE OF STOCK OVER PAST THREE YEARS;

(in NT$ / share)

Stock	Price	2006	2005	2004
Common	Highest	35.0	37.6	37.4
	Lowest	24.4	23.2	27.0
	Average	29.7	30.8	32.5
Preferred	Highest	36.0	37.2	37.0
	Lowest	28.5	27.5	29.5
	Average	32.0	32.1	33.2

Source of Information: Taiwan Stock Exchange Corporation

PRODUCTS AND USES

Products	Major Uses
Plates	Shipbuilding, bridges, steel structures, oil country tubular goods (OCTGs), storage tanks, boilers, pressure vessels, truck chassis and general construction
Bars	Nuts and bolts, hand tools, loudspeaker parts, automobile and motor cycle parts, machinery parts
Wire rods	Nuts and bolts, steel wire and rope, welding electrodes, hand tools, tire cord and bead, umbrella parts, chains
Hot rolled coils and sheets	Steel pipes and tubes, vehicle parts, containers, pressure vessels, hydraulic jacks, cold rolled and galvanized products, light shapes, formed parts in general
Cold rolled coils	Steel pipes and tubes , steel furniture, home appliances, oil barrels, automobile bodies, hardwares, and as raw material for galvanized and coated steel sheets
Electro-galvanized coils	Computer cases, home appliance outer shells, parts and accessories, automobile bodies, building materials and components, and hardwares
Hot-dip galvanized coils	Automobile parts and components, computer cases, color coated sheets, building materials and components
Electrical steel coils	Motors, transformers and stabilizers

THREE YEAR SUMMARY OF PRODUCTION AND SALES VOLUMES

(In tons)

Product	Volume	2006	2005	2004
Steel plates	Production	**1,075,520**	1,092,799	1,167,083
	Sales	**1,079,049**	1,084,629	1,197,730
Steel bars[24]	Production	**525,560**	596,648	569,443
	Sales	**563,206**	635,356	611,765
Wire rods	Production	**1,139,030**	1,207,256	1,287,021
	Sales	**1,134,526**	1,211,944	1,305,604
Hot rolled steel products	Production	**4,349,382**	3,908,732	4,095,068
	Sales	**4,376,337**	3,978,283	4,246,913
Cold rolled steel products[25]	Production	**2,643,518**	2,695,851	2,752,700
	Sales	**2,772,194**	2,728,482	2,885,865
Commercial slabs, blooms and billets	Production	**197,854**	181,011	209,526
	Sales	**286,958**	151,388	165,198
Pig iron	Production	**14,616**	15,711	20,448
	Sales	**13,079**	13,929	17,041
Total	Production	**9,945,481**	9,698,007	10,101,289
	Sales	**10,225,349**	9,804,011	10,430,116

[24] Including bars contracted out for hire-rolling

[25] Including electrogalvanized, hot-dip galvanized products and electric sheets

China Steel Corporation

Financial Statements

for the Years Ended December 31, 2006 and 2005 and

Independent Auditors' Report

Deloitte.

勤業眾信

INDEPENDENT AUDITORS' REPORT

The Board of Directors and Stockholders
China Steel Corporation

We have audited the accompanying balance sheets of China Steel Corporation (the "Corporation") as of December 31, 2006 and 2005, and the related statements of income, changes in stockholders' equity and cash flows for the years then ended. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the Rules Governing the Audit of Financial Statements by Certified Public Accountants and auditing standards generally accepted in the Republic of China (ROC). Those rules and standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to in the first paragraph present fairly, in all material respects, the financial position of the Corporation as of December 31, 2006 and 2005, and the results of its operations and its cash flows for the years then ended, in conformity with the Guidelines Governing the Preparation of Financial Reports by Securities Issuers, requirements of the Business Accounting Law and Guidelines Governing Business Accounting relevant to financial accounting standards, and accounting principles generally accepted in the ROC.

Effective 2006, as stated in Note 3 to the accompanying financial statements, the Corporation adopted the newly issued Statement of Financial Accounting Standards (SFAS) No. 34 "Accounting for Financial Instruments," SFAS No. 36 "Disclosure and Presentation of Financial Instruments" and the related revisions to other SFASs.

Deloitte & Touche

February 7, 2007

<u>*Notice to Readers*</u>

The accompanying financial statements are intended only to present the financial position, results of operations and cash flows in accordance with accounting principles and practices generally accepted in the Republic of China and not those of any other jurisdictions. The standards, procedures and practices to audit such financial statements are those generally accepted and applied in the Republic of China.

For the convenience of readers, the auditors' report and the accompanying financial statements have been translated into English from the original Chinese version prepared and used in the Republic of China. If there is any conflict between the English version and the original Chinese version or any difference in the interpretation of the two versions, the Chinese-language auditors' report and financial statements shall prevail. Also, as stated in Note 2 to the financial statements, the additional footnote disclosures that are not required under generally accepted accounting principles were not translated into English.

BALANCE SHEETS

CHINA STEEL CORPORATION

DECEMBER 31, 2006 AND 2005

(In Thousands of New Taiwan Dollars, Except Par Value)

ASSETS	2006 Amount	%	2005 Amount	%
CURRENT ASSETS				
Cash and cash equivalents (Notes 2 and 4)	$16,196,611	6	$17,739,481	7
Financial assets at fair value through profit or loss - current (Notes 2 and 5)	12,315,988	5	10,975,710	4
Available-for-sale financial assets - current (Notes 2 and 6)	4,935,322	2	1,218,156	1
Notes receivable (Note 7)	1,336,278	1	1,641,032	1
Accounts receivable (Notes 2 and 7)	2,737,167	1	2,034,629	1
Other receivables	272,550	-	546,006	-
Inventories (Notes 2 and 8)	32,410,868	12	35,792,031	14
Deferred income tax assets (Note 21)	172,190	-	143,975	-
Pledged time deposits (Note 25)	3,650,000	1	4,600,000	2
Other	1,019,180	-	1,160,737	-
Total current assets	75,046,154	28	75,851,757	30
LONG-TERM INVESTMENTS				
Available-for-sale financial assets - noncurrent (Notes 2 and 6)	2,851,977	1	1,001,210	-
Financial assets carried at cost - noncurrent (Notes 2 and 9)	5,766,315	2	6,173,510	3
Investment in bonds without quoted price - noncurrent (Notes 2 and 10)	5,482,324	2	5,881,374	2
Long-term stock investment - equity method (Notes 2 and 11)	60,630,662	23	52,825,719	21
Total long-term investments	74,731,278	28	65,881,813	26
PROPERTIES (Notes 2, 12, 24 and 25)				
Land	8,322,881	3	7,994,055	3
Land improvements	4,212,123	2	4,216,794	2
Buildings and improvements	37,423,461	14	36,016,863	14
Machinery and equipment	219,788,073	83	212,821,181	85
Transportation equipment	1,473,130	-	1,452,514	1
Miscellaneous equipment	3,096,559	1	3,013,382	1
Total cost	274,316,227	103	265,514,789	106
Appreciation	17,249,891	7	17,668,482	7
Total cost and appreciation	291,566,118	110	283,183,271	113
Less: Accumulated depreciation	203,035,577	76	197,384,284	79
	88,530,541	34	85,798,987	34
Constructions in progress	21,922,773	8	19,768,057	8
Net properties	110,453,314	42	105,567,044	42
OTHER ASSETS				
Rental assets - net (Notes 2 and 13)	3,039,354	1	3,066,346	2
Refundable deposits	55,833	-	346,830	-
Restricted assets - pledged time deposits (Note 25)	31,694	-	31,694	-
Unamortized repair costs and others (Note 2)	2,269,068	1	16,856	-
Total other assets	5,395,949	2	3,461,726	2
TOTAL	$265,626,695	100	$250,762,340	100

LIABILITIES AND STOCKHOLDERS' EQUITY	2006 Amount	%	2005 Amount	%
CURRENT LIABILITIES				
Short-term loans and overdraft (Note 14)	$16,609,989	6	$11,473,383	4
Commercial paper payable (Note 15)	-	-	1,499,376	1
Notes and accounts payable (Notes 7 and 24)	3,610,786	2	2,336,407	1
Income tax payable (Note 21)	5,682,534	2	7,578,477	3
Accrued expenses (Notes 2 and 18)	7,929,764	3	7,159,512	3
Other payables	3,237,957	1	2,890,008	1
Bonds payable - current portion (Note 16)	-	-	10,000,000	4
Long-term bank loans - current portion (Note 17)	-	-	727,220	-
Other	1,857,490	1	1,444,863	1
Total current liabilities	38,928,520	15	45,109,246	18
LONG-TERM LIABILITIES				
Bonds payable, net of current portion (Note 16)	13,700,000	5	-	-
Bank loans, net of current portion (Notes 17 and 25)	3,426,250	1	2,769,030	1
Total long-term liabilities	17,126,250	6	2,769,030	1
RESERVE FOR LAND VALUE INCREMENT TAX (Note 12)	2,171,124	1	2,171,124	1
OTHER LIABILITIES				
Deferred income tax liabilities (Note 21)	2,716,689	1	2,944,097	1
Deferred credits - gain on intercompany transactions (Note 19)	1,150,940	-	1,142,352	1
Total other liabilities	3,867,629	1	4,086,449	2
Total liabilities	62,093,523	23	54,135,849	22
CAPITAL STOCK - authorized 12,000,000 thousand shares at NT$10 par value (Notes 2 and 20)				
Common shares - issued 11,053,758 thousand shares and 10,545,974 thousand shares as of December 31, 2006 and 2005, respectively	110,537,576	42	105,459,736	42
Preferred shares - issued 40,694 thousand shares and 40,698 thousand shares as of December 31, 2006 and 2005, respectively	406,940	-	406,980	-
Total capital stock	110,944,516	42	105,866,716	42
CAPITAL SURPLUS (Notes 2 and 20)	1,548,370	1	1,209,378	-
RETAINED EARNINGS (Notes 2 and 20)	83,429,463	31	90,107,602	36
OTHER EQUITY ITEMS				
Cumulative translation adjustments (Note 2)	(62,787)	-	(335,992)	-
Investees' unrecognized net loss on pension cost	(37,358)	-	(36,872)	-
Unrealized gain (loss) on financial instruments (Notes 3, 6 and 11)	7,533,737	3	(446,483)	-
Revaluation increment on assets (Notes 3, 12, 19 and 20)	1,512,123	-	1,535,363	-
Total other equity items	8,945,715	3	716,016	-
TREASURY STOCK– 82,780 thousand shares and 79,199 thousand shares as of December 31, 2006 and 2005, respectively	(1,334,892)	-	(1,273,221)	-
Total stockholders' equity	203,533,172	77	196,626,491	78
TOTAL	$265,626,695	100	$250,762,340	100

The accompanying notes are an integral part of the financial statements.
(With Deloitte & Touche audit report dated February 7, 2007)

STATEMENTS OF INCOME

CHINA STEEL CORPORATION

YEARS ENDED DECEMBER 31, 2006 AND 2005

(In Thousands of New Taiwan Dollars, Except Earnings Per Share)

	2006 Amount	%	2005 Amount	%
REVENUES (Notes 2, 24 and 29)	$ 177,658,233	100	$ 186,317,669	100
COST OF REVENUES (Notes 22 and 24)	134,216,258	76	118,991,792	64
GROSS PROFIT	43,441,975	24	67,325,877	36
UNREALIZED (REALIZED) GAIN ON INTERCOMPANY TRANSACTIONS	(26,208)	-	376,905	-
REALIZED GROSS PROFIT	43,468,183	24	66,948,972	36
OPERATING EXPENSES (Notes 22 and 24)				
Selling	2,324,447	1	2,248,551	1
General and administrative	2,281,730	1	2,682,343	1
Research and development	1,117,278	1	1,114,714	1
Total operating expenses	5,723,455	3	6,045,608	3
OPERATING INCOME	37,744,728	21	60,903,364	33
NONOPERATING INCOME AND GAINS				
Interest	343,746	-	540,381	-
Investment income under the equity method (Note 11)	9,631,087	6	4,442,401	3
Gain on appraisal of financial assets (Note 5)	148,954	-	412,496	-
Other	1,299,162	1	1,574,407	1
Total nonoperating income and gains	11,422,949	7	6,969,685	4
NONOPERATING EXPENSES AND LOSSES				
Interest (Note 12)	541,823	-	734,335	-
Impairment loss on financial assets carried at cost (Note 9)	272,000	-	906,000	1
Other	675,101	1	1,120,285	1
Total nonoperating expenses and losses	1,488,924	1	2,760,620	2
INCOME BEFORE INCOME TAX	47,678,753	27	65,112,429	35
INCOME TAX (Notes 2 and 21)	8,482,347	5	14,465,790	8

(Continued)

	2006 Amount	%	2005 Amount	%
INCOME BEFORE CUMULATIVE EFFECT OF CHANGES IN ACCOUNTING PRINCIPLES	$ 39,196,406	22	$ 50,646,639	27
CUMULATIVE EFFECT OF CHANGES IN ACCOUNTING PRINCIPLES (Note 3) (Net of $64,547 thousand income tax benefit in 2006)	(37,822)	-	-	-
NET INCOME	$ 39,158,584	22	$ 50,646,639	27

	2006 Before Tax	2006 After Tax	2005 Before Tax	2005 After Tax
EARNINGS PER SHARE (Note 23)				
Basic	$ 4.33	$ 3.56	$ 5.93	$ 4.61
Diluted	$ 4.32	$ 3.56	$ 5.91	$ 4.60

PRO FORMA INFORMATION - if the Corporation's shares held by subsidiaries had been accounted for as investments rather than treasury stock

	2006	2005
Income before cumulative effect of changes in accounting principles	$ 39,535,300	$ 50,966,883
Net income	39,497,478	50,966,883
Basic earnings per share based on weighted-average number of outstanding common shares 11,052,158 thousand and 11,053,729 thousand as of December 31, 2006 and 2005, respectively	$ 3.57	$ 4.61
Diluted earnings per share based on weighted-average number of outstanding common shares 11,092,852 thousand and 11,094,427 thousand as of December 31, 2006 and 2005, respectively	$ 3.56	$ 4.59

(Concluded)

The accompanying notes are an integral part of the financial statements.
(With Deloitte & Touche audit report dated February 7, 2007)

STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

CHINA STEEL CORPORATION

YEARS ENDED DECEMBER 31, 2006 AND 2005
(In Thousands of New Taiwan Dollars, Except Cash Dividends Per Share)

	Capital Stock			Retained Earnings									
	Common Stock	Preferred Stock	Capital Surplus	Legal Reserve	Special Reserve	Unappropriated	Total	Revaluation Increment on Assets	Unrealized Gain (Loss) on Financial Instruments	Cumulative Translation Adjustments	Investees' Unrecognized Net Loss on Pension Cost	Treasury Stock	Total Stockholders' Equity
BALANCES, JANUARY 1, 2005	$98,889,368	$ 421,770	$ 833,146	$25,452,594	$8,030,816	$52,159,008	$85,642,418	$ 339,174	$ (454,039)	$ (365,599)	$ (32,003)	$(1,113,121)	$184,161,114
Conversion of preferred stock to common shares	14,790	(14,790)	-	-	-	-	-	-	-	-	-	-	-
Adjustment of reserve for land value increment tax (Note 12)	-	-	-	-	-	-	-	1,196,189	-	-	-	-	1,196,189
Appropriation of 2004 earnings (Note 20)													
Legal reserve	-	-	-	5,161,667	-	(5,161,667)	-	-	-	-	-	-	-
Special reserve	-	-	-	-	436,524	(436,524)	-	-	-	-	-	-	-
Bonus to employees	1,590,021	-	-	-	-	(2,304,056)	(2,304,056)	-	-	-	-	-	(714,035)
Remuneration to directors and supervisors	-	-	-	-	-	(138,243)	(138,243)	-	-	-	-	-	(138,243)
Cash dividends to preferred shareholders - $3.9 per share	-	-	-	-	-	(158,785)	(158,785)	-	-	-	-	-	(158,785)
Cash dividends to common shareholders - $3.9 per share	-	-	-	-	-	(38,572,559)	(38,572,559)	-	-	-	-	-	(38,572,559)
Stock dividends to preferred shareholders - 5%	20,357	-	-	-	-	(20,357)	(20,357)	-	-	-	-	-	-
Stock dividends to common shareholders - 5%	4,945,200	-	-	-	-	(4,945,200)	(4,945,200)	-	-	-	-	-	-
Net income in 2005	-	-	-	-	-	50,646,639	50,646,639	-	-	-	-	-	50,646,639
Adjustment of equity in investees due to change in percentage of ownership	-	-	55,853	-	-	(42,255)	(42,255)	-	-	-	-	(213,620)	(200,022)
Reversal of unrealized loss on investees' long-term investments	-	-	-	-	-	-	-	-	7,556	-	-	-	7,556
Cumulative translation adjustments on long-term investments	-	-	-	-	-	-	-	-	-	29,607	-	-	29,607
Investees' unrecognized net loss on pension cost	-	-	-	-	-	-	-	-	-	-	(4,869)	-	(4,869)
Disposal of the Corporation's shares held by subsidiaries	-	-	34,425	-	-	-	-	-	-	-	-	60,955	95,380
Cash dividends declared by the Corporation and received by subsidiaries	-	-	285,954	-	-	-	-	-	-	-	-	-	285,954
Reacquired the Corporation's issued shares	-	-	-	-	-	-	-	-	-	-	-	(7,435)	(7,435)
BALANCES, DECEMBER 31, 2005	105,459,736	406,980	1,209,378	30,614,261	8,467,340	51,026,001	90,107,602	1,535,363	(446,483)	(335,992)	(36,872)	(1,273,221)	196,626,491
Adjustment upon adoption of the newly issued Statement of Financial Accounting Standard No. 34 (Note 3)	-	-	-	-	-	-	-	-	3,936,398	261,188	-	-	4,197,586
Conversion of preferred stock to common shares	40	(40)	-	-	-	-	-	-	-	-	-	-	-
Appropriation of 2005 earnings (Note 20)													
Legal reserve	-	-	-	5,060,439	-	(5,060,439)	-	-	-	-	-	-	-
Special reserve	-	-	-	-	(22,347)	22,347	-	-	-	-	-	-	-
Bonus to employees	1,373,025	-	-	-	-	(2,288,375)	(2,288,375)	-	-	-	-	-	(915,350)
Remuneration to directors and supervisors	-	-	-	-	-	(137,302)	(137,302)	-	-	-	-	-	(137,302)
Cash dividends to preferred shareholders - $3.75 per share	-	-	-	-	-	(152,618)	(152,618)	-	-	-	-	-	(152,618)
Cash dividends to common shareholders - $3.75 per share	-	-	-	-	-	(39,541,401)	(39,541,401)	-	-	-	-	-	(39,541,401)
Stock dividends to preferred shareholders - 3.5%	14,244	-	-	-	-	(14,244)	(14,244)	-	-	-	-	-	-
Stock dividends to common shareholders - 3.5%	3,690,531	-	-	-	-	(3,690,531)	(3,690,531)	-	-	-	-	-	-
Net income in 2006	-	-	-	-	-	39,158,584	39,158,584	-	-	-	-	-	39,158,584
Unrealized gain (loss) on available-for-sale financial assets	-	-	-	-	-	-	-	-	1,646,395	-	-	-	1,646,395
Reclassify to nonoperating income due to disposal of appreciated properties	-	-	-	-	-	-	-	(23,240)	-	-	-	-	(23,240)
Adjustment of equity in investees due to change in percentage of ownership	-	-	(78)	-	-	(12,252)	(12,252)	-	2,397,427	-	-	(71,556)	2,313,541
Cumulative translation adjustments on long-term investments	-	-	-	-	-	-	-	-	-	12,017	-	-	12,017
Investees' unrecognized net loss on pension cost	-	-	-	-	-	-	-	-	-	-	(486)	-	(486)
Reacquired the Corporation's issued shares	-	-	-	-	-	-	-	-	-	-	-	(32,096)	(32,096)
Disposal of the Corporation's shares held by subsidiaries	-	-	38,071	-	-	-	-	-	-	-	-	41,981	80,052
Cash dividends declared by the Corporation and received by subsidiaries	-	-	300,999	-	-	-	-	-	-	-	-	-	300,999
BALANCES, DECEMBER 31, 2006	$110,537,576	$ 406,940	$1,548,370	$35,674,700	$8,444,993	$39,309,770	$83,429,463	$1,512,123	$7,533,737	$ (62,787)	$ (37,358)	$(1,334,892)	$203,533,172

The accompanying notes are an integral part of the financial statements.
Additional explanations for stockholder's equity accounts are in Appendix.
(With Deloitte & Touche audit report dated February 7, 2007)

STATEMENTS OF CASH FLOWS

CHINA STEEL CORPORATION

YEARS ENDED DECEMBER 31, 2006 AND 2005
(In Thousands of New Taiwan Dollars)

	2006	2005
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 39,158,584	$ 50,646,639
Cumulative effect of changes in accounting principles	37,822	-
Adjustments		
Depreciation	9,357,647	9,418,781
Amortization	505,859	87,520
Deferred income tax	(191,076)	(17,548)
Cash dividends from long-term investments under the equity method	4,956,820	5,282,274
Investment income under the equity method	(9,631,087)	(4,442,401)
Constructive dividends from investment in bonds without quoted price	399,050	102,951
Impairment loss on financial assets carried at cost	272,000	906,000
Gain on appraisal of financial assets	(148,954)	(412,496)
Unrealized loss (gain) on intercompany transactions	(26,208)	376,905
Effect of exchange rate changes on foreign-currency long-term debts	619	(287,960)
Reversal of allowance for loss on inventories	-	(164,689)
Others	(81,069)	244,684
Net changes in operating assets and liabilities		
Notes receivable	304,754	70,303
Accounts receivable	(702,538)	27,534
Inventories	3,419,504	(9,715,611)
Other receivable	273,456	(319,826)
Other current assets	141,557	(1,012,252)
Notes and accounts payable	1,274,379	(749,933)
Income tax payable	(1,895,943)	(1,826,588)
Accrued expenses	817,054	60,499
Other payables	(1,038,867)	1,806,051
Other current liabilities	447,422	(815,799)
Net cash provided by operating activities	47,650,785	49,265,038
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of financial assets at fair value through profit or loss	(17,900,161)	(19,550,886)
Proceeds from disposal of financial assets at fair value through profit of loss	16,864,655	31,624,551
Purchase of financial assets carried at cost	(75,760)	(1,058,554)
Proceeds from disposal of financial assets carried at cost	4,955	83,103
Purchase of investment in bonds without quoted price	-	(3,349,944)
Increase in long-term stock investments under equity method	(289,554)	(13,250,926)
Proceeds from reduced capital on long-term investments under equity method	-	597,639
Acquisition of properties	(12,911,588)	(16,028,779)
Proceeds from disposal of properties	1,836	96,234
Decrease (increase) in refundable deposits	290,997	(273,038)
Proceeds from reduced capital on financial assets carried at cost	18,000	-

(Continued)

	2006	2005
Decrease in pledged time deposits	$ 950,000	$ 100,000
Decrease (increase) in other assets	(2,757,586)	3,464
Net cash used in investing activities	(15,804,206)	(21,007,136)
CASH FLOWS FROM FINANCING ACTIVITIES		
Increase in short-term bank loans and overdraft	5,136,606	7,007,423
Decrease in commercial paper payable	(1,499,376)	(299,676)
Repayments of bonds payable	(10,000,000)	(5,000,000)
Increase in bonds payable	13,700,000	-
Increase in long-term loans	-	923,010
Purchase of treasury stocks	(32,096)	(7,435)
Cash dividends	(39,641,931)	(38,692,230)
Remuneration to directors and supervisors and bonus to employees	(1,052,652)	(852,278)
Net cash used in financing activities	(33,389,449)	(36,921,186)
NET DECREASE IN CASH AND CASH EQUIVALENTS	(1,542,870)	(8,663,284)
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	17,739,481	26,402,765
CASH AND CASH EQUIVALENTS, END OF YEAR	$ 16,196,611	$ 17,739,481
SUPPLEMENTAL INFORMATION		
Interest paid (exclusive of capitalized interest)	$ 573,342	$ 742,881
Income tax paid	10,569,366	16,309,926
PURCHASE OF PROPERTIES		
Acquisition of properties	$ 14,246,316	$ 16,054,622
Increase in payable on properties purchased	(1,334,728)	(25,843)
	$ 12,911,588	$ 16,028,779
PAYMENTS OF CASH DIVIDENDS		
Total cash dividends payable to stockholders	$ 39,694,019	$ 38,731,344
Increase in dividends payable	(52,088)	(39,114)
	$ 39,641,931	$ 38,692,230
NONCASH FINANCING ACTIVITIES		
Current portion of long-term liabilities	$ -	$ 10,727,220

(Concluded)

The accompanying notes are an integral part of the financial statements.
(With Deloitte & Touche audit report dated February 7, 2007)

CHINA STEEL CORPORATION

NOTES TO FINANCIAL STATEMENTS
YEARS ENDED DECEMBER 31, 2006 AND 2005
(In Thousands of New Taiwan Dollars, Except Amounts Stated Otherwise, Earnings and Dividends Per Share)

1. ORGANIZATION AND OPERATIONS

China Steel Corporation (the "Corporation") was incorporated on December 3, 1971. It manufactures and sells steel products and engages in machinery and communications engineering and construction.

The Corporation's stock is listed on the Taiwan Stock Exchange. As of December 31, 2006, the Ministry of Economic Affairs (previously the Ministry of Finance), Republic of China owned 22.7% of the Corporation's outstanding common stock.

As of December 31, 2006 and 2005, the Corporation had about 9,000 and 8,700 employees, respectively.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The accompanying financial statements have been prepared in conformity with the Guidelines Governing the Preparation of Financial Reports by Securities Issuers, requirements of the Business Accounting Law and Guidelines Governing Business Accounting and accounting principles generally accepted in the Republic of China (ROC). Under these guidelines and principles, the Corporation is required to make certain estimates and assumptions on recorded assets, liabilities, revenues and expenses, including those related to doubtful accounts, inventory loss, depreciation of properties, impairment loss on assets, pension and loss on lawsuits. Actual results could differ from these estimates.

For the convenience of readers, the accompanying financial statements have been translated into English from the original Chinese version prepared and used in the ROC. If there is any conflict between the English version and the original Chinese version or any difference in the interpretation of the two versions, the Chinese-language financial statements shall prevail. However, the accompanying financial statements do not include the English translation of additional disclosures that are not required under generally accepted accounting principles but are required by the Securities and Futures Bureau (SFB, formerly the Securities and Futures Commission before July 1, 2004) for their oversight purposes.

The Corporation's significant accounting policies are summarized as follows:

Current and Noncurrent Assets and Liabilities

Current assets include unrestricted cash, cash equivalents, assets held mainly for operating purposes, and other assets to be realized in cash or to be consumed within 12 months from the balance sheet date. Properties and other assets which do not belong to current assets are classified as non-current. Liabilities to be settled within 12 months from the balance sheet date are classified as current. Liabilities which do not belong to current liabilities are classified as noncurrent.

Cash Equivalents

Cash equivalents are short-term notes and bills with maturities of three months or less. The carrying value of cash equivalents approximates fair value.

Financial Assets at Fair Value Through Profit or Loss

Financial instruments (mainly open-end funds) are recognized as financial assets at fair value through profit or loss to remove significant accounting inconsistency. These financial instruments are initially recognized at fair value and its transaction costs are expensed currently. When subsequently measured at fair value, the changes in fair value are recognized in current income. A regular way purchase or sale of financial assets is recorded using trade date accounting.

Fair value is based on net asset value of open-end funds on balance sheet date.

Available-for-sale Financial Assets

Available-for-sale financial assets are initially recognized at fair value plus transaction costs that are directly attributable to the acquisition. When subsequently measured at fair value, the changes in fair value are excluded from earnings and reported as a separate component of stockholders' equity. The accumulated gains or losses are recognized in earnings when the financial asset is derecognized from the balance sheet. A regular way purchase or sale of financial assets is recorded using trade date accounting.

Cash dividends received from and after the year of investment acquisition are recognized as income in the period received. Stock dividends are recognized only as an increase in the number of shares of stock held on the ex-dividend date. Costs of investments sold are determined by the weighted-average method. Any difference between the initial carrying amounts of a debt security and the amount due at maturity is amortized using the straight – line method and the amortization is credited or charged to income.

If there is objective evidence that a financial asset is impaired, an impairment loss is recognized. If, in a subsequent period, the amount of the impairment loss decreases, for equity securities, the previously recognized impairment loss is reversed to the extent of the decrease and recorded as an adjustment to stockholders' equity; for debt securities, the amount of the decrease is recognized in earnings, provided that the decrease is clearly attributable to an event which occurred after the impairment loss was recognized.

Fair value is based on the closing price on balance sheet date for listed stocks and determined by using valuation technique for financial instruments without quoted price.

Factoring of Accounts Receivable

The following three conditions must be met to recognize factoring of accounts receivable:

a. The accounts receivable have been legally isolated from the Corporation.

b. The transferees have obtained the right to pledge or exchange the accounts receivable, which are either the transferred accounts receivable or beneficial interest in the transferred assets.

c. The transferor does not maintain effective control, through an agreement to repurchase or redeem the transferred accounts receivable before their maturity, over the transferred accounts receivable.

If the three conditions are met, the difference between the proceeds and the face value of the accounts receivable is recognized as a loss and recorded as nonoperating expenses.

Inventories

Inventories are raw materials, supplies, fuel, finished products, work in process and by-products. Inventories are stated at the lower of total moving average cost or market value. Market value is the net realizable value for finished products, work in process and by-products, and replacement costs for raw materials, supplies and fuel.

Financial Assets Carried at Cost

Investments that do not have a quoted market price in an active market and whose fair value cannot be reliably measured are carried at original cost, such as non-publicly traded stocks and mutual funds. If there is objective evidence that a financial asset is impaired, an impairment loss is recognized. No recording of a subsequent recovery in fair value is allowed.

The accounting treatment for cash dividends and stock dividends on financial assets carried at cost is the same as that for cash and stock dividends on available-for-sale financial assets.

Investment in Bonds Without Quoted Price

Investment that does not have a quoted market price in an active market and the receipt upon maturity is fixed or definite is carried at the amortized cost. Those financial assets are initially recognized at fair value plus transaction cost that are directly attributable to the acquisition. Earnings or losses are recognized at the time of derecognition, impairment or amortization.

If there is objective evidence that a financial asset is impaired, an impairment loss is recognized. If, in a subsequent period, the amount of the impairment loss decreases and the decrease is clearly attributable to an event which occurred after the impairment loss was recognized, the previously recognized impairment loss is reversed to the extent of the decrease. The reversal should not result in a carrying amount of the financial asset that exceeds the amortized cost that would have been determined if no impairment loss had been recognized.

Long-term Stock Investment - Equity Method

Long-term stock investments in which the Corporation owns 20% or more of the outstanding voting shares or where the Corporation has significant influence on the investees are accounted for by the equity method. When the equity method is first applied or when a stock is acquired, the difference between the carrying value of an investment and the proportionate equity in the investee is amortized over five years.

Effective January 1, 2006, pursuant to the revised Statement of Financial Accounting Standards (SFAS) No.5 “Long-term Investment under Equity Method,” investment premiums, representing goodwill, are no longer being amortized, but annual impairment test is required. The investment discounts, representing the fair value of identifiable net assets acquired over investment costs, are allocated proportionately based on the fair values of noncurrent asset amounts and any remaining unallocated balance is recorded as extraordinary income. The investment discounts that existed prior to January 1, 2006 will continue to be amortized over five years.

If an investee issues additional shares and the Corporation acquires shares at a percentage different from its current equity in the investee, capital surplus is adjusted for the difference between the carrying values of the investments and the Corporation’s equity in the investee’s net assets. If the carrying value is less than equity in net assets, the difference is added to capital surplus. If the carrying value is more than equity in net assets, the difference is deducted from capital surplus, or from unappropriated earnings when capital surplus is not enough for debiting purposes.

If the market prices of investees - equity securities significantly decline below carrying value and the decline is permanent, the investment loss should be recognized as realized loss in the same year of the decline. This investment will be revalued if an investee’s market value becomes higher than book value per share. The difference between the new cost of the investment and the proportionate equity in the investee is amortized over five years.

Properties

Properties are stated at cost or cost plus appreciation, less accumulated depreciation. Interest expense for the purchase or construction of properties is capitalized as property cost. Major additions, renewals and betterments are capitalized, while maintenance and repairs are expensed currently.

Depreciation is calculated by the straight-line method over service lives estimated as follows: land improvements, 10 to 40 years; buildings and improvements, 5 to 60 years; machinery and equipment, 3 to 25 years; transportation equipment, 3 to 25 years; and miscellaneous equipment, 3 to 10 years. Depreciation on appreciation is calculated by the straight-line method over the remaining service lives of the revalued assets. When a property reaches its residual value but is still in use, its residual value is depreciated over its reestimated service life.

Upon sale or other disposal of properties, the related cost, appreciation and accumulated depreciation are removed from the accounts. Gains or losses are credited or charged to current income.

Rental Assets

Rental assets (included in other assets) are stated at the lower of carrying value or recoverable value.

Asset Impairment

Assets (primarily properties, rental assets and long-term investments under the equity method) are evaluated on the basis of their recoverable value. If the recoverable value is less than the carrying value of the assets, the decline is charged to impairment loss and accumulated impairment loss is established. If the value of the impaired assets recovers, the accumulated impairment loss will be reversed. However, the loss reversal is only to the extent that the increased carrying amount of an asset does not exceed the asset carrying amount (net of depreciation) that would have been determined had no impairment loss been recognized in prior years.

Unamortized Repair Costs

Unamortized repair costs refer to the major repairs of blast furnaces and are amortized over five years.

Treasury Stock

The Corporation reacquired its issued shares in accordance with government regulations and recorded this reacquisition as treasury stock at cost, which is presented as a deduction to stockholders’ equity.

Effective 2002, the Corporation’s shares acquired and held by subsidiaries are reclassified to treasury stock from long-term investments and accounted for at the carrying value recorded by subsidiaries for short-term or long-term investments as of January 1, 2002.

Effective 2005, the revised SFAS No. 7, “Consolidated Financial Statements,” requires that equity-method investees that are not majority-owned but over which the Corporation has controlling capability in substance are deemed as subsidiaries. Thus, the Corporation’s shares held by these investees are recorded as treasury stock.

Revenue Recognition and Allowance for Doubtful Accounts

Revenues are recognized when titles to products and risks of ownership are transferred to customers as follows: domestic sales - when products are delivered out of the Corporation’s premises to customers; exports - when products are loaded onto vessels.

Sales are measured at fair value, the price (net of trade discounts and sales discounts) agreed to by the Corporation and customers. But if the related receivable is due within one year, the difference between its present value and receivable amount is immaterial, and sales transactions are frequent, the fair value of receivables is equivalent to the nominal amount of cash to be received.

An allowance for doubtful receivable is provided based on a review of the collectibility of accounts receivable. The Corporation determines the amount of allowance for doubtful receivable by examining the aging analysis of outstanding accounts receivable and current trends in the credit quality of its customers.

Capitalization and Expense

Expenditure which amount is significant and has future economic benefits is classified as asset; otherwise is classified as expense or loss.

Pension

Pension costs under defined benefit pension plan are recognized on the basis of actuarial calculations. The difference between the actuarial pension cost and the amount appropriated to a special fund (Note 18) is recognized as accrued pension liability (included in accrued expenses). Unamortized net transition assets and actuarial gain or loss are amortized over 11 years and the average remaining service life of employees, respectively.

Pension costs under defined contribution plan are recognized based on the amount of actual contributions made by the Corporation to the employees' individual pension accounts.

Income Tax

Income tax is provided based on inter-period allocation basis. Tax effects of deductible temporary differences are recognized as deferred income tax assets. Valuation allowance is provided for deferred tax assets with uncertain realizability. Tax effects of taxable temporary differences are recognized as deferred tax liabilities. A deferred tax asset or liability is classified as current or noncurrent depending on the classification of the related asset or liability for financial reporting. But if the deferred income tax asset or liability cannot be related to an asset or liability for financial reporting, the classification is based on the expected reversal or realization date of the temporary difference.

Tax credits arising from expenditures for purchases of equipment, research and development, employees' training, and investment in newly emerging, important and strategic industries are recognized when those credits are granted.

Adjustments of prior years' tax liabilities are added to or deducted from the current year's tax expense.

Annual earnings are appropriated under a resolution adopted in the stockholders' meeting in the year following the year of earnings generation. Under tax regulations, unappropriated earnings generated from January 1, 1998 are subject to 10% income tax. This tax is recorded as expense in the year when the stockholders resolve to retain the earnings.

Foreign-currency Transactions

Foreign-currency transactions, except derivative transactions, are recorded in New Taiwan dollars at the rates of exchange in effect when the transactions occur. Gains or losses resulting from the application of prevailing exchange rates when foreign-currency assets and liabilities are settled or converted, are credited or charged to income in the year of settlement or conversion. On the balance sheet date, foreign-currency assets and liabilities are restated at the prevailing exchange rates, and resulting differences are accounted for as follows:

(a) Equity-method stock investments - as cumulative translation adjustments under stockholders' equity;

(b) Other assets and liabilities - as credits or charges to current income.

Foreign – currency financial assets carried at cost are stated at the historical rate.

The spot exchange rates use the middle price of the Taipei Foreign Exchange Trading Centre.

Hedge Accounting

The Corporation uses financial instruments to hedge the currency change of a net investment in a foreign operation. The hedge is attributable to fair value hedge and using the non-derivative financial instruments to be the hedge tools.

For the fair value hedge, both the fair value change of the investments and financial instruments are recorded as gain or loss in the current period.

The Corporation uses the hedge activities to control the net investment currency exchange and fair value risk.

Reclassification

As stated in Note 3, certain accounts for the year ended December 31, 2005 had been reclassified to conform to the classifications in 2006.

3. ACCOUNTING CHANGES

Effective 2006, the Corporation adopted the newly issued SFAS No.34 "Accounting for Financial Instruments" No.36 "Disclosure and Presentation of Financial Instruments" and the related revisions of previously released SFASs.

a. Effect of adopting the newly released SFASs and related revisions of previously released SFASs

   The Corporation had properly categorized its financial assets and liabilities upon initial adoption of the newly released SFASs and related revisions of previously released SFASs. The adjustments made to the carrying amounts of the financial instruments categorized as financial assets or financial liabilities at fair value through profit or loss were included in the cumulative effect of changes in accounting principles; on the other hand, the adjustments made to the carrying amounts of those categorized as financial assets carried at cost and available-for-sale financial assets were recognized as adjustments to shareholders' equity.

   In addition, the foreign-currency investment under cost method is reclassified as financial assets carried at cost which were revalued based on the historical exchange rate at initial investment date and adjustment was made to cumulative translation adjustment recorded in shareholders' equity and related financial assets.

   The Corporation also reassessed the hedge effectiveness for the equity investment in East Asia United Steel Corporation and adjusted the exchange loss of $193,641 thousand previously recorded to cumulative effect of changes in accounting principles.

The effect of adopting the newly released SFASs is summarized as follows:

	Recognized as Cumulative Effect of Changes in Accounting Principles (Net of Tax)	Recognized as a Separate Component of Stockholders' Equity (Net of Tax)
Financial assets at fair value through profit or loss	$ 155,819	$ -
Available-for-sale financial assets	-	3,936,398
Financial assets carried at cost	(193,641)	261,188
	$ (37,822)	$ 4,197,586

The net effect of the change in accounting principles is not significant to the Corporation's net income and basic earnings per share for the year ended December 31, 2006.

b. Reclassifications

Upon the adoption of SFAS No.34, certain accounts in the financial statements as of and for the year ended December 31, 2005 were reclassified to conform with the financial statements as of and for the year ended December 31, 2006. The previously issued financial statements as of and for the year ended December 31, 2005 were not required to be restated.

Certain accounting policies prior to the adoption of the newly released SFASs are summarized as follows:

1) Short-term investments

Short-term investments that were publicly-traded, easily converted to cash, and not acquired for the purpose of controlling the investees or establishing close business relationship with the investees were carried at the lower of cost or market value at the balance sheet date, with any temporary decline in value charged to current income. The market value of publicly-traded stocks was determined using the average-closing prices for the last month of the period.

2) Long-term stock investment

Long-term stock investments in which the Corporation owns less than 20% of the outstanding voting shares or where the Corporation has no significant influence on the investees are accounted for by the cost method. The investments listed on the Taiwan Stock Exchange are stated at the lower of total cost or market value and unrealized loss on long-term investment is classified as a deduction item of the stockholders' equity.

On the balance sheet date, foreign-currency assets and liabilities are restated at the prevailing exchange rates, and resulting differences are accounted for as cumulative translation adjustments under stockholders' equity if restated balances are lower than their costs; otherwise, no adjustment is made.

Certain accounts in the financial statements as of and for the year ended December 31, 2005 have been reclassified to conform to the classifications prescribed by the newly released and revised SFASs. The reclassifications of certain accounts are summarized as follows:

	Before Reclassification	After Reclassification
Balance sheet		
Short-term investments	$ 16,693,866	$ -
Long-term investments	13,056,094	-
Unrealized loss on long-term investments	(446,483)	-
Financial assets at fair value through profit or loss	-	10,975,710
Available-for-sale financial assets - current	-	1,218,156
Available-for-sale financial assets - noncurrent	-	1,001,210
Investment in bonds without quoted price- noncurrent	-	5,881,374
Financial assets carried at cost - noncurrent	-	6,173,510
Unrealized loss on financial instrument	-	(446,483)
Cash and cash equivalents	-	4,500,000
Income statement		
Gain on disposal of investments	412,496	-
Impairment loss on long-term investment	906,000	-
Gain on appraisal of financial assets	-	412,496
Impairment loss on financial assets carried at cost	-	906,000

Effective January 1, 2006, the Corporation adopted the amended SFAS No.1 "Conceptual Framework for Financial Accounting and Preparation of Financial Statements," No.5 "Long-Term Investment under Equity Method" and No.25 "Business Combinations." The amendments of the SFASs mainly provided that the carrying value of investment and the proportionate equity shall be analyzed, and goodwill should be tested for impairment annually and is no longer being amortized. Such change did not have significant impact on the Corporation's financial statements as of and for the year ended December 31, 2006.

c. Revision of the Business Accounting Law

Certain accounts in the financial statements as of and for the year ended December 31, 2005 have been reclassified to conform to the revision of the Business Accounting Law. The reclassification of the account balances was as follows:

	Before Reclassification	After Reclassification
Capital surplus	$ 1,535,363	$ -
Revaluation increment on assets – stockholders' equity	-	1,535,363

4. CASH AND CASH EQUIVALENTS

	2006	2005
Cash on hand	$ 18,704	$ 20,273
Checking accounts and demand deposits	872,368	2,320,639
Time deposits	2,700,000	3,700,000
Negotiable certificate of time deposits	3,000,000	4,500,000
Cash equivalents - short-term notes and bills	9,605,539	7,198,569
	$ 16,196,611	$ 17,739,481

As of December 31, 2006, the Corporation had foreign bank deposits of ¥8,685 thousand in Japan-Osaka Bank and ¥27,904 thousand in Singapore - Daiwa Securities SMBC with the total of $10,057 thousand.

5. FINANCIAL ASSETS AT FAIR VALUE THROUGH PROFIT OR LOSS

This mainly represents open-end funds. As of December 31, 2006 and 2005, the balances of financial assets at fair value through profit or loss were $12,315,988 thousand and $10,975,710 thousand, respectively. The purpose of classifying open-end funds to this account is to remove the accounting inconsistency between investment income and interest expense.

Net gain arising from the financial assets at fair value through profit or loss for the year ended December 31, 2006 was $148,954 thousand (including gain on appraisal and disposal of financial assets).

6. AVAILABLE-FOR-SALE FINANCIAL ASSETS

	2006		2005	
	Current	Noncurrent	Current	Noncurrent
Listed stock				
Maruichi Steel Tube Ltd.	$ -	$ 757,920	$ -	$ 757,920
Advanced Material Technology Corporation (AMTC)	-	243,290	-	243,290
Tang Eng Iron Works Corporation (TEIWC)	-	-	-	-
Taiwan Semiconductor Manufacturing Company (TSMC)	967,456	-	967,456	-
Bank debentures - Taiwan Cooperative Bank	250,460	-	250,700	-
Allowance for appraisal	3,717,406	1,850,767	-	-
	$ 4,935,322	$ 2,851,977	$ 1,218,156	$ 1,001,210

In July 2006, Tang Eng Iron Works Corporation's stock was listed on the Gre Tai Securities Market. Accordingly, this financial asset carried at cost was classified as available-for-sale financial asset. The Corporation recognized an unrealized gain on appraisal of $895,821 thousand on this financial asset.

The unrealized gain on the above mentioned financial assets determined at fair value as at December 31, 2006 was $1,646,395 thousand.

The Corporation borrowed foreign-currency bank loans in the same amounts with the hedged investment to hedge exchange rate fluctuation risks on the investments in Maruichi Steel Tube Ltd. (Notes 17 and 27)

7. NOTES AND ACCOUNTS RECEIVABLE

The Corporation entered into three factoring accounts receivable contracts (without recourse) with Mega International Commercial Bank (formerly The International Commercial Bank of China merged with the Bank of Communications to form Mega International Commercial Bank), Bank of Taiwan and Taipei Fubon Bank for the facilities of $5.84 billion, $2.5 billion and $0.8 billion, respectively. Under the contracts, the Corporation is empowered to sell accounts receivable to the banks upon the delivery of products to customers and is required to complete related formalities at the next banking day.

The Corporation entered into a commercial paper purchasing contract, which was due on October 31, 2005, with Mega Bills Finance Corporation (formerly Chung Hsing Bills Finance Corporation) for the facility of $2.5 billion. Customers will issue commercial papers to the Corporation upon the delivery of products. The commercial papers will be sold to Mega Bills Finance Corporation (without recourse) upon the Corporation's endorsements.

As of December 31, 2006, there was no outstanding endorsed commercial paper.

The related information for the Corporation's sale of its notes and accounts receivable for the year ended December 31, 2006 and 2005 is as follows:

Transaction Counter - party	Total Factoring Amounts	Related Expenses	Proceeds Received	Interest Rate (%)
2006				
Accounts Receivable				
Mega International Commercial Bank	$ 9,088,245	$ 73,956	$ 9,014,289	1.57 ~ 1.95
Bank of Taiwan	1,069,512	6,494	1,063,018	1.57 ~ 1.95
Taipei Fubon Bank	45,040	284	44,756	2.02 ~ 2.15
	$ 10,202,797	$ 80,734	$ 10,122,063	
2005				
Notes Receivable				
Mega Bills Finance Corporation	$ 3,368,849	$ 20,531	$ 3,348,318	1.70 ~ 2.10
Accounts Receivable				
Mega International Commercial Bank	5,898,506	43,579	5,854,927	1.64 ~ 2.10
Bank of Taiwan	3,208,548	21,386	3,187,162	1.64 ~ 4.16
	9,107,054	64,965	9,042,089	
	$ 12,475,903	$ 85,496	$ 12,390,407	

8. INVENTORIES

	2006	2005
Finished products	$ 6,555,804	$ 6,776,286
Work in process	9,947,583	9,293,601
Raw materials	6,730,833	12,320,916
Supplies	5,471,366	5,210,244
Materials in transit and others	2,667,036	1,733,764
Fuel	151,547	89,186
Others	886,699	368,034
	$ 32,410,868	$ 35,792,031

9. FINANCIAL ASSETS CARRIED AT COST

	2006	2005
Common stocks without quoted market prices		
Industrial Bank of Taiwan	$ 1,000,000	$ 1,000,000
CDIB & Partners Investment Holding Corporation	500,000	500,000
CDIB BioScience Ventures I, Inc. (CBVI)	102,000	120,000
Hsun Hsin Cement Enterprise Corp.	75,760	-
Phalanx Biotech Group Corporation (PBG)	73,370	105,370

(Continued)

	2006	2005
Overseas Investment & Development Corporation	$ 50,000	$ 50,000
CTB I Venture Capital Co., Ltd.	50,000	50,000
Asia Pacific Broadband Telecom Co., Ltd. (APBT)	-	240,000
Kaohsiung Arena Development Corp. (KADC) (Note 11)	-	135,000
Tang Eng Iron Works Corporation (TEIWC) (Note 6)	-	-
Preferred stocks without quoted market prices		
East Asia United Steel Corporation (EAUS)	2,741,000	2,794,000
Dragon Steel Corporation	999,877	999,877
Fund - Sino-Canada Biotechnology Development Fund, LP (SCBDF)	174,308	179,263
	$ 5,766,315	$ 6,173,510

The stocks which do not have quoted prices and their fair value cannot be measured reliably were classified as financial assets carried at cost.

In June 2006, CBVI reduced its capital and returned $18,000 thousand to the Corporation.

In August 2006, the Corporation invested $75,760 thousand for limestones supply to acquire 8,609 thousand shares of Hsun Hsin Cement Enterprise Corp. ($8.8 per share), representing 9% equity, which manufactures and sells cement products.

In May 2003, the Corporation signed a slab production joint-venture contract with Sumitomo Metal Industries, Ltd. and Sumitomo Corporation. In July 2003, the joint venture company of East Asia United Steel Corporation (EAUS) was established. As of December 31, 2006, the Corporation had invested in EAUS the amount of ￥10 billion (Notes 17 and 27). The Corporation thus enjoys a stable supply of good quality slab from this joint venture. The Corporation also signed a contract with Chung Hung Steel Corporation (CHSC) to transfer the purchasing right of slabs from EAUS, and the Corporation receives premiums on this contract based on the volume purchased by CHSC.

The Corporation promised to invest 100 units ($10,000 thousand Canadian dollars) in the SCBDF fund. As of December 31, 2006, the Corporation had invested $219,025 thousand (CAD$9,435 thousand) in SCBDF fund. The difference between the above cumulative investment and the carrying value was cash dividends received by the Corporation.

In September 2006, PBG reduced its capital to offset a deficit. Accordingly, the Corporation recognized an impairment loss of $32,000 thousand.

In 2006 and 2005, the Corporation recognized an impairment loss of $240,000 thousand and $906,000 thousand (recorded as nonoperating loss) on its investment in APBT, respectively.

10. INVESTMENT IN BONDS WITHOUT QUOTED PRICE

	2006	2005
Taiwan High Speed Rail Corporation (THSRC)		
Preferred C	$ 4,297,940	$ 4,646,990
Preferred B	884,384	934,384
Taigen Biotechnology Co., Ltd. (TBC)	300,000	300,000
	$ 5,482,324	$ 5,881,374

In September 2003, the Corporation acquired 100,000 thousand Preferred B shares (representing 4% of ownership) of THSRC for $1,000,000 thousand. Dividend on these shares is at 5%, payable on a nonparticipating and cumulative basis. These shares with six years of durations could be extended for 13 months prior to 3 months of the due date. In April 2005 and August 2004, the Corporation acquired additional 505,370 thousand Preferred C shares of THSRC for $3,199,944 thousand and $1,499,996 thousand, respectively. These shares, representing 19% of ownership, which may be converted to common shares within four years from the acquisition date, have a 9.5% dividend in the first two years and 0% in the next two years. At the end of four years, i.e., in 2009 and 2008, if the Corporation does not convert the Preferred C shares into common shares and THSRC cannot redeem the shares, the unredeemed shares will have 4.71% dividends. THSRC mainly builds and operates public transportation systems.

In November 2005 and March 2004, the Corporation acquired a total of 20,000 thousand preferred shares of TBC for $300,000 thousand. Preferred shareholders are entitled to 8% participating and noncumulative dividends as well as 9% voting and election rights. TBC mainly researches and develops drugs. The Corporation can request TBC to redeem all or part of preferred shares by issuing new stock or its own retained earnings after July of 2007.

11. LONG-TERM STOCK INVESTMENTS UNDER EQUITY METHOD

	2006		2005	
	Amount	% of Ownership	Amount	% of Ownership
Stocks listed on the Taiwan Stock Exchange				
Chung Hung Steel Corporation (CHSC)	$ 2,759,685	24	$ 1,138,751	24
China Steel Chemical Corporation (CSCC)	1,226,692	30	1,099,876	30
China Hi-ment Corporation (CHC)	656,151	20	619,815	20
China Steel Structure Corporation (CSSC)	499,023	18	471,177	18
China Ecotek Corporation (CEC)	373,658	36	407,238	36
	5,515,209		3,736,857	
Less: Shares held by subsidiaries accounted for as treasury stock	332,196		333,214	
	5,183,013		3,403,643	
Stocks without quoted market prices				
Dragon Steel Corporation (DSC)	15,731,795	47	15,122,411	47
Gains Investment Corporation (GIC)	8,788,400	100	6,341,240	100
China Steel Express Corporation (CSE)	8,631,926	100	7,870,266	100
C. S. Aluminum Corporation (CAC)	7,387,741	100	7,031,956	100
China Prosperity Development Corporation (CPDC)	4,680,646	100	4,721,157	100
Kaohsiung Rapid Transit Corporation (KRTC)	3,035,260	31	3,112,060	31
China Steel Asia Pacific Holdings Pte Ltd (CSAPH)	2,683,091	100	2,408,502	100
Goang Yaw Investment Corporation (Goang Yaw) and other two investment companies	1,877,523	99	817,541	99
China Steel Global Trading Corporation (CSGT)	1,193,585	100	1,135,359	100
China Steel Machinery Corporation (CSMC)	861,088	100	826,656	100
Info-Champ Systems Corporation (ICSC)	644,834	100	554,411	100
Kaohsiung Arena Development Corporation (KADC)	260,606	18	-	-
China Steel Security Corporation (CSS)	250,071	100	236,689	100
Taiwan Rolling Stock Co., Ltd. (TRSC)	226,194	22	164,447	27

(Continued)

	2006 Amount	2006 % of Owner-ship	2005 Amount	2005 % of Owner-ship
Hi-mag Magnetic Corporation (HMC)	$ 94,324	50	$ -	50
Baolai Greeting Development Co., Ltd. (BGDC)	50,136	45	-	-
China Steel Management Consulting Corporation (CSMCC)	9,458	38	8,533	38
TaiAn Technologies Corporation (TTC)	4,136	17	3,420	17
	56,410,814		50,354,648	
Less: Shares held by subsidiaries accounted for as treasury stock	963,165		932,572	
	55,447,649		49,422,076	
	$ 60,630,662		$ 52,825,719	

As of December 31, 2006 and 2005, the Corporation's total equity in CHSC was 39%, including directly owned - 24% and indirectly owned - 15%. The Corporation's total equity in TTC was 22%, including directly owned - 17% and indirectly owned through CSCC - 5%. In March 2005 and November 2004, the Corporation had totally invested $135,000 thousand in KADC and invested additional $135,000 thousand in June and September 2006. The Corporation's subsidiary also invested in KADC in 2006, thus, the Corporation and subsidiary's total equity in KADC was 33%, including directly owned - 18% and indirectly owned - 15%. Accordingly, the investment in KADC carried at cost was changed to be accounted for by equity method.

In 2005, DSC issued additional shares and declared stock dividends for its preferred stock. The Corporation further increased its investment in DSC by 980,032 thousand shares for $13,230,426 thousand ($13.5 per share) and common stock dividends appropriated from DSC received by the Corporation. The Corporation's equity in DSC increased from 37% to 47%.

In August 2005, CSAPH reduced its capital and returned US$18,000 thousand (29,455 thousand shares) to the Corporation.

In May 2006, the Corporation invested $54,000 thousand to acquire 5,400 thousand shares of BGDC, representing 45% equity. The Corporation plans to invest in BGDC a total of $216,000 thousand. BGDC will engage in hotel business and is currently in the development stage.

The market value of above listed stocks was $11,527,090 thousand and $6,625,280 thousand based on the closing prices on December 31, 2006 and average closing prices in December 2005, respectively.

The Corporation's Board of Directors approved plans for additional investments in China Shipbuilding Corp., DSC, TRSC, etc. The related subscription schedule depends on the investees' capital increase requirements. As of December 31, 2006, the Corporation's future infused capital in these investees aggregated $6,722,831 thousand.

Investment income (loss) under the equity method was as follows:

	2006	2005
CSE	$ 3,452,173	$ 2,722,709
CHSC, Goang Yaw and other two subsidiaries	2,623,804	(1,174,216)
GIC	886,902	692,336
CAC	689,395	483,448

(Continued)

	2006	2005
DSC	$ 642,517	$ 366,086
CSCC	362,817	304,511
CSGT	357,284	355,539
CSAPH	285,331	185,550
CHC	135,591	136,701
ICSC	83,440	83,685
CSMC	34,173	135,794
CSSC	17,733	184,297
CEC	(8,829)	40,771
Others	68,756	(74,810)
	$ 9,631,087	$ 4,442,401

Above investment income (loss) was recognized based on the investees' audited financial statements.

The Corporation has prepared the consolidated financial statements including all majority-owned and controlled-in-substance subsidiaries in accordance with the related regulations.

12. PROPERTIES

	Cost	Appreciation	Total
December 31, 2006			
Cost and appreciation			
Land	$ 8,322,881	$ 5,840,732	$ 14,163,613
Land improvements	4,212,123	492,990	4,705,113
Buildings and improvements	37,423,461	2,423,546	39,847,007
Machinery and equipment	219,788,073	8,433,643	228,221,716
Transportation equipment	1,473,130	27,233	1,500,363
Miscellaneous equipment	3,096,559	31,747	3,128,306
	274,316,227	17,249,891	291,566,118
Accumulated depreciation			
Land improvements	3,221,503	432,626	3,654,129
Buildings and improvements	16,343,315	1,678,984	18,022,299
Machinery and equipment	169,297,383	8,431,852	177,729,235
Transportation equipment	1,151,393	27,222	1,178,615
Miscellaneous equipment	2,419,566	31,733	2,451,299
	192,433,160	10,602,417	203,035,577
Constructions in progress	21,922,773	-	21,922,773
	$ 103,805,840	$ 6,647,474	$ 110,453,314

(Continued)

December 31, 2005	Cost	Appreciation	Total
Cost and appreciation			
Land	$ 7,994,055	$ 5,840,732	$ 13,834,787
Land improvements	4,216,794	492,990	4,709,784
Buildings and improvements	36,016,863	2,424,236	38,441,099
Machinery and equipment	212,821,181	8,844,981	221,666,162
Transportation equipment	1,452,514	33,748	1,486,262
Miscellaneous equipment	3,013,382	31,795	3,045,177
	265,514,789	17,668,482	283,183,271
Accumulated depreciation			
Land improvements	3,097,184	421,746	3,518,930
Buildings and improvements	15,356,709	1,623,030	16,979,739
Machinery and equipment	164,474,811	8,841,645	173,316,456
Transportation equipment	1,170,916	33,728	1,204,644
Miscellaneous equipment	2,332,735	31,780	2,364,515
	186,432,355	10,951,929	197,384,284
Constructions in progress	19,768,057	-	19,768,057
	$ 98,850,491	$ 6,716,553	$ 105,567,044

In the purchase of properties in 2006, the capitalized interest information is disclosed as follows:

Interest expense before capitalization	$ 636,177
Capitalized interest – construction in progress	(94,354)
Interest expense through income statement	$ 541,823
Interest rates of interest expenses capitalized (annual rate)	1.64%-2.23%

In 1981 and 1994, the Corporation revalued its properties and patents in accordance with government regulations, resulting in an increment of $17,662,343 thousand. After the deduction of the reserve for land value increment tax of $3,370,813 thousand, an increment of $14,291,530 thousand was credited to capital surplus. As of December 31, 2006, capital surplus from revaluation of assets totaling $13,952,356 thousand had been transferred to capital stock, reducing the balance of capital surplus from revaluation of assets to $339,174 thousand. In January 2005, the government revised the land increment tax law to reduce the tax rate. Thus, the reserve for land value increment tax decreased and the capital surplus from revaluation increment increased each by $1,196,189 thousand. Accordingly, the balance of capital surplus from revaluation increment increased to $1,535,363 thousand. In 2006, upon retirement or sale of appreciated properties, the capital surplus from revaluation increment decreased by $23,240 thousand. Such decrease was reclassified to nonoperating revenue.

In 2005, the Corporation decreased the reserve for land value increment tax by $3,500 thousand resulting from sale of its land, building and equipment situated in Taipei with a gain on disposal of $68,026 thousand. As of December 31, 2006, the balance of reserve for land value increment tax amounted to $2,171,124 thousand.

In January 2005, the Corporation repurchased land from CPDC for $834,673 thousand, and after offsetting unrealized gain on intercompany transaction of $268,876 thousand which occurred in 1999, the actual purchase cost was $565,797 thousand.

13. RENTAL ASSETS - NET

	2006	2005
Land - at cost	$ 2,966,632	$ 2,966,398
Machinery and equipment - at cost	2,000,000	2,000,000
Less: Accumulated depreciation	1,333,278	1,306,052
Accumulated impairment loss	594,000	594,000
	72,722	99,948
	$ 3,039,254	$ 3,066,346

The Corporation has leased some of its plant property and machinery to its subsidiaries (Note 24).

14. SHORT-TERM BANK LOANS AND OVERDRAFT

	2006	2005
Credit loans - interest at 1.658%-1.73% p.a. and 1.387%-1.479% p.a. as of December 31, 2006 and 2005, respectively	$ 13,900,000	$ 7,500,000
Letters of credit - due within 180 days; interest at 0.7%-5.7833% p.a. and 0.26%-5.38% p.a. as of December 31, 2006 and 2005, respectively	489,422	674,869
Overdraft - interest at 1.49%-1.701% p.a. and 1.1%-2.72% p.a. as of December 31, 2006 and 2005, respectively	2,220,567	3,298,514
	$ 16,609,989	$ 11,473,383

15. COMMERCIAL PAPER PAYABLE

	2005
Commercial paper - interest rates at 1.15%-1.34% p.a. as of December 31, 2005	$ 1,500,000
Unamortized discounts	(624)
	$ 1,499,376

16. LONG-TERM BONDS PAYABLE

	2006	2005
5-year unsecured bonds - issued at par in:		
November 2006; repayable in November 2011; 2.07% interest p.a., payable annually	$ 5,600,000	$ -
June 2006; repayable in June 2011; 2.32% interest p.a., payable annually	8,100,000	-
November 2001; repayable in November 2006; 3.1% interest p.a., payable annually	-	3,500,000
November 2001; repayable in November 2006; 3.0763% interest p.a., compounded semiannually and payable annually	-	1,500,000

(Continued)

	2006	2005
June 2001; repayable in June 2006; 4.27% interest p.a., payable annually	$ -	$ 5,000,000
	13,700,000	10,000,000
Current portion	-	10,000,000
	$ 13,700,000	$ -

17. LONG-TERM DEBTS

	2006	2005
Repayable in July 2010 (¥4.4 billion); floating rates at 0.69% and 0.2288% p.a. as of December 31, 2006 and 2005, respectively	$ 1,206,040	$ 1,230,680
Repayable in December 2009 (¥2.6 billion); floating rates at 0.8563% and 0.2310% p.a. as of December 31, 2006 and 2005, respectively	712,660	727,220
Repayable in July 2010 (¥2.2 billion); floating rates at 0.8034% and 0.2750% p.a. as of December 31, 2006 and 2005, respectively	603,020	615,340
Repayable in July 2010 (¥3.3 billion); floating rates at 0.7719% and 0.3625% p.a. as of December 31, 2006 and 2005, respectively	904,530	923,010
	3,426,250	3,496,250
Current portion	-	727,220
	$ 3,426,250	$ 2,769,030

As of December 31, 2006, the Corporation borrowed long-term bank loans in yen to hedge the exchange rate fluctuations on the investments in yen in East Asia United Steel Corporation and Maruichi Steel Tube Ltd (Note 6).

18. PENSION PLAN

The Labor Pension Act (the "Act") became effective on July 1, 2005. The Corporation's regular employees hired before June 30, 2005, have chosen to continue their pension plan under the Labor Standards Law (those employees may change their choice to the "Act" before July 1, 2010), or have chosen the pension plan under the Act, but retained their employment seniority earned until June 30, 2005. Employees hired after July 1, 2005 can only adopt the pension plan under the Act.

Under the Act, a defined contribution plan, the Corporation makes monthly contribution to employees' personal retirement account at amounts equal to 6% of the salaries and wages of employees.

The pension costs are as follows:

	2006	2005
Under Labor Standards Law	$ 1,422,843	$ 1,369,536
Under Labor Pension Act	10,283	1,773
	$ 1,433,126	$ 1,371,309

The Corporation has a retirement plan in accordance with the Labor Standards Law. Retirement benefits are based on employee's length of service and his/her average salaries and wages of the last six months before retirement.

The Corporation makes contributions, equal to a certain percentage of salaries, to a pension fund, which is deposited in the Central Trust of China in the name of, and administered by the employees' pension fund administration committee. The changes in the fund are summarized as follows:

	2006	2005
Balance, beginning of year	$ 11,759,018	$ 10,503,035
Contributions	1,473,971	1,289,951
Gains	248,241	117,438
Payment of benefits	(294,130)	(151,406)
Balance, end of year	$ 13,187,100	$ 11,759,018

Since August 1999, the Corporation also made contributions, equal to a certain percentage of salaries of management personnel (vice presidents and above), to another pension fund, which is deposited in The Mega International Commercial Bank in the name of, and administered by an officers' pension fund management committee. The changes in the fund are summarized as follows:

	2006	2005
Balance, beginning of year	$ 14,478	$ 9,982
Contributions	3,316	4,343
Interest income	270	153
Payment of benefits	(1,290)	-
Balance, end of year	$ 16,774	$ 14,478

Under SFAS No. 18, pension information based on actuarial calculation is as follows:

	2006	2005
a. Net pension cost		
Service cost	$ 1,313,716	$ 1,254,577
Interest cost	486,928	431,026
Expected return on plan assets	(425,333)	(335,227)
Amortization	47,532	19,160
	$ 1,422,843	$ 1,369,536
b. Reconciliation of the funded status of the plan and accrued pension liability		
Benefit obligation		
Vested	$ 304,305	$ 263,749
Non-vested	12,173,110	10,603,429
Accumulated	12,477,415	10,867,178
Additional benefits based on future salaries	3,270,173	3,181,579
Projected	15,747,588	14,048,757
Fair value of plan assets	(13,403,529)	(11,936,196)
Funded status	2,344,059	2,112,561

(Continued)

	2006	2005
Unrecognized net asset at transition	$ 71,519	$ 81,055
Unamortized net actuarial loss	(2,303,011)	(2,032,626)
Accrued pension liabilities (included in accrued expense)	$ 112,567	$ 160,990

The difference between the pension fund and the fair value of plan assets as of December 31, 2006 and 2005 represented the accrued interest income of the fund.

	2006	2005
c. Vested benefits	$ 328,828	$ 284,753

d. Actuarial assumptions

Discount rate used in determining present values	3.5%	3.5%
Future salary increase rate	3.0%	3.0%
Expected rate of return on plan assets	2.5%	3.5%

19. DEFERRED CREDITS - GAIN ON INTERCOMPANY TRANSACTION

	2006	2005
Gain on disposal of land	$ 1,136,164	$ 1,136,164
Gain on contracted projects	14,776	6,188
	$ 1,150,940	$ 1,142,352

A deferred income of $1,405,040 thousand was the unrealized gain from the sale of land to CPDC in February 1999. The Corporation repurchased some of the land in the first half of 2005 for construction of office building and thus the deferred credits decreased by $268,876 thousand. The remaining deferred credit will be recognized as income when CPDC sells the rest of the land to third parties.

The Corporation obtained building construction projects from KRTC, resulting in deferred revenue. The accumulated credits will be recognized as income over the service lives of the buildings after completion of the construction, expected in 2007 to 2009.

20. STOCKHOLDERS' EQUITY

a. Capital stock

In 2006 and August 2005, the Corporation, through capitalization of retained earnings, issued new common shares of 507,780 thousand and 655,558 thousand, respectively.

In 2006 and 2005, 4 thousand shares and 1,479 thousand shares of preferred stock were converted into common stock. As of December 31,2006, 3 thousand shares of which were not yet registered with the government.

b. Treasury stock

Purpose	Thousand Shares Beginning of Year	Increase	Decrease	End of Year Thousand Shares	Book Value
2006					
1) Shares acquired and held by subsidiaries	78,899	4,955	2,674	81,180	$ 1,295,361
2) Shares acquired by the Corporation for transfer to employees	300	1,300	-	1,600	39,531
	79,199	6,255	2,674	82,780	$ 1,334,892
2005					
1) Shares acquired and held by subsidiaries	106,652	6,891	34,644	78,899	$ 1,265,786
2) Shares acquired by the Corporation for transfer to employees	-	300	-	300	7,435
	106,652	7,191	34,644	79,199	$ 1,273,221

1) Shares acquired and held by subsidiaries

The Corporation's shares acquired and held by subsidiaries (with 50% or more shareholdings) were accounted for as treasury stock (recorded as long-term or financial assets - current by investees). As mentioned in Note 2, effective 2005, the Corporation's shares acquired and held by other equity-method investees substantially controlled by the Corporation were also reclassified as treasury stock. This accounting change resulted in an increase of 22,189 thousand treasury shares in treasury stock, with a carrying value of $539,707 thousand as of January 1, 2005. In 2006 and 2005, treasury stock increased by 4,955 thousand shares and 6,891 thousand shares, due to subsidiaries' purchase and the Corporation's capitalization of retained earnings; treasury stock decreased by 2,674 thousand shares and 34,644 thousand shares due to subsidiaries' sales of their holdings of the Corporation's shares and due to change in percentage of ownership. The difference between the sale prices ($80,052 thousand in 2006 and $95,380 thousand in 2005) and carrying values of $38,071 thousand and $34,425 thousand were credited to capital surplus.

As of December 31, 2006 and 2005, the market values of those treasury shares are $2,808,816 thousand and $1,922,771 thousand, respectively.

Although these shares (the Corporation held with 50% or more shareholdings) are treated as treasury stock in the financial statements, the stockholders are entitled to exercise their rights on these stocks, except participation in the Corporation's capital increase by cash. However, effective June 2005, the revised Company Law restricts the treasury stockholders from exercise of voting rights. The shares held by the equity-method investees substantially controlled by the Corporation can still have the same rights with other common stockholders.

2) Shares acquired for transfer to employees

The Corporation under relevant regulations reacquired its issued common shares from the public market at a total of 1,600 thousand shares during December 2005 to February 2006.

Under the Securities Transaction Law, the Corporation's share repurchase is restricted to up to 10% of total issued shares, and the total purchase amount should not exceed the sum of retained earnings, paid-in capital in excess of par value and realized capital surplus. In addition, the Corporation should transfer those shares to employees within three years. Otherwise these shares are deemed unissued and the Corporation should then register with the government for capital decrease. Further, the Corporation should not pledge these stocks as collateral and should not collect dividends or exercise voting rights on these stocks.

c. Overseas depositary receipts

In May 1992, February 1997 and October 2003, the ROC's Ministry of Economic Affairs (MOEA) (the shares were transferred to the Ministry of Finance in 2005 and re-transferred to the Ministry of Economic Affairs in October 2006) sold its shares in the Corporation through issuances of 88,329,150 units of Global Depositary Receipts (international GDR), with each unit representing 20 shares of the Corporation's common stock, or equivalent to the Corporation's common shares totalling 1,879,517,614 shares. The depositary shares then increased by 5,646,722 resulting from the capitalization of retained earnings. Under relevant regulations, the GDR holders may also request the conversion to the shares represented by the International GDR. The foreign investors may also request the reissuance of such depositary receipts within the originally approved units. As of December 31, 2006, the outstanding depositary receipts were 8,562,913 units, equivalent to 171,258,414 common shares, which represented 1.55% of the outstanding common shares.

d. Preferred stock

Preferred stockholders have the following entitlements or rights:

1) 14% annual dividends, with dividend payments ahead of those to common stockholders;

2) Preference over common stock in future payment of dividends in arrears;

3) Redemption of stock, at the Corporation's option out of its retained earnings or the proceeds from issuance of new shares;

4) The same rights as common stockholders, except the right to vote for directors and supervisors; and

5) Conversion of shares into common stock.

e. Capital surplus

Following are the capital surplus sources:

	2006	2005
Treasury stock transaction	$1,305,851	$ 960,872
Long-term stock investments under the equity method	234,420	240,407
Others	8,099	8,099
	$1,548,370	$1,209,378

Under relevant regulations, capital surplus from treasury stock transaction may be used to offset a deficit or transferred to capital. Capital surplus from long-term stocks investments accounted for under the equity method is prohibited from any use.

f. Other items

Revaluation increment on assets may only be used to offset a deficit. In the future, the Corporation, except the appropriations in accordance with the Company Law, shall return the revaluation increment on assets from retained earnings before any appropriations are made.

As of December 31, 2006, the Corporation's revaluation increment on assets was not used to offset a deficit.

g. Appropriation of retained earnings

The Corporation's Articles of Incorporation provides that the annual net income, less any deficit, should be appropriated in the following order of presentation:

1) 10% as legal reserve, until its balance equals the issued capital stock;

2) Preferred stock dividends at 14% of paid-in capital;

3) Of the remainder, 0.3% as compensation to directors and supervisors and 3% to 5% as bonus to employees;

4) Common stock dividends at 14% of paid-in capital; and

5) The remainder, if any, as additional dividends divided equally between the holders of preferred and common stocks.

The Board of Directors should propose the appropriation of annual income. If necessary, it may, after appropriating preferred stock dividends at 14% of paid-in capital, propose to retain certain earnings as a special reserve. These proposals should be submitted to the stockholders' meeting for approval.

The Corporation is required to appropriate a special reserve from annual earnings for any net debit balance resulting from adjustments to the stockholders' equity, excluding treasury stock. Effective 2002, if the market price is lower than the carrying value of the Corporation's shares held by subsidiaries, the Corporation should appropriate a special reserve equal to the difference between market price and carrying value. The Corporation may release a portion of this special reserve when debit balances are partially or fully reversed.

The Corporation's steel business is in a phase of stable growth; thus, more than 75% of the appropriation of dividends and bonus should be in cash and less than 25% in stock.

Under the Company Law, legal reserve should be appropriated from retained earnings until its balance equals the issued capital stock. Legal reserve may be used to offset a deficit, or be distributed as dividends and bonuses for the portion in excess of 50% of the paid-in capital if the Corporation has no unappropriated earnings and the reserve balance has exceeded 50% of the Corporation's capital stock. The Company Law also prescribes that, when the reserve has reached 50% of the Corporation's capital stock, up to 50% of the reserve may be transferred to capital.

The Corporation's stockholders in their June 2006 and 2005 meetings approved the following appropriations of the 2005 and 2004 earnings, which were proposed by the Board of Directors in March 2006 and 2005, respectively.

	Amount 2005	Amount 2004	Dividends Per Share 2005	Dividends Per Share 2004
Legal reserve	$ 5,060,439	$ 5,161,667		
Special reserve	(22,347)	436,524		
Preferred Stocks				
Cash dividends	152,618	158,785	$ 3.75	$ 3.90
Stock dividends	14,244	20,357	0.35	0.50
			$ 4.10	$ 4.40
Common Stocks				
Cash dividends	39,541,401	38,572,559	$ 3.75	$ 3.90
Stock dividends	3,690,531	4,945,200	0.35	0.50
			$ 4.10	$ 4.40
Remuneration to directors and supervisors	137,302	138,243		
Bonus to employees				
Cash dividends	915,350	714,035		
Stock dividends	1,373,025	1,590,021		
	$ 50,862,563	$ 51,737,391		

As of February 7, 2007, the auditors' report date, the appropriation of 2006 earnings had not been proposed by the Board of Directors.

Information on the Board of Directors' proposed appropriation of earnings and related stockholders' meeting may be accessed through the Web site of the Taiwan Stock Exchange Corporation.

h. Effect of bonus to employees and remuneration to directors and supervisors if charged to expense

The aforementioned appropriation of bonus to employees and remuneration to directors and supervisors was as follows:

	Amount	Shares (Thousands)	Percentage to Common Shares Outstanding as of each year-end (%)
2005			
Bonus to employees			
Stock dividends	$ 1,373,025	137,303	1.30
Cash dividends	915,350	-	-
Remuneration to directors and supervisors - cash	137,302	-	-
	$ 2,425,677		
2004			
Bonus to employees			
Stock dividends	$ 1,590,021	159,002	1.61
Cash dividends	714,035	-	-
Remuneration to directors and supervisors - cash	138,243	-	-
	$ 2,442,299		

Had the bonus to employees and remuneration to directors and supervisors been charged to expense (stock bonus calculation was based on par value) in 2005 and 2004, the basic earnings per share (after tax) for 2005 and 2004 would have decreased (the capitalization of retained earnings in 2006 and 2005 were already reflected as retroactive adjustment of the shares for 2005 and 2004) from $4.61 to $4.39 for 2005 and from $4.93 to $4.70 for 2004.

21. INCOME TAX

The ROC government enacted the Alternative Minimum Tax Act ("AMT Act"), which became effective on January 1, 2006. The alternative minimum tax ("AMT") imposed under the AMT Act is a supplemental tax levied at a rate of 10% which is payable if the income tax payable determined pursuant to the Income Tax Law is below the minimum amount prescribed under the AMT Act. The taxable income for calculating the AMT includes most of the income that is exempted from income tax under various laws and statutes. The Company has considered the impact of the AMT Act in the determination of its tax liabilities.

a. Reconciliation between the income tax expense and the income tax calculated on pre-tax financial statement income based on the statutory tax rate:

	2006	2005
Tax on pretax income at statutory rate (25%)	$ 11,919,688	$ 16,278,107
Add (deduct) tax effects of differences of:		
Permanent		
Investment income under equity method - domestic	(2,336,439)	(1,064,213)
Unrealized gain on appraisal of financial assets and disposal of Investment	(37,239)	(103,227)
Cash dividends - domestic	(68,001)	(59,201)
Others	(9,137)	(14,806)
	(2,450,816)	(1,241,447)
Temporary		
Impairment loss on financial assets carried at cost	68,000	226,500
Depreciation	158,549	177,765
Reversal of allowance for loss on inventory	-	(41,172)
Unrealized (realized) gain on intercompany transactions	(6,552)	94,226
Investment income under equity method - foreign	(71,333)	(46,387)
Unrealized (realized) foreign exchange gain	22,483	(89,399)
Investment loss resulting from investees' capital return	(10,939)	(102,180)
Accrued Electrostatic Precipitator dust disposal expense	31,934	-
Cash dividends - foreign	-	164,897
Others	3,383	(54,203)
	195,525	330,047
Income tax payable based on taxable income	9,664,397	15,366,707
Tax credits	(1,070,145)	(884,544)
Prior periods' adjustments	47,253	(48,692)
Separate income tax on interest income	31,918	49,867
Tax payable	8,673,423	14,483,338
Deferred tax adjustments	(191,076)	(17,548)
	$ 8,482,347	$ 14,465,790

(Continued)

	2006	2005
b. Change in income tax payable		
Balance, beginning of year	$ 7,578,477	$ 9,405,065
Current income tax	8,673,423	14,483,338
Payment in the current year	(10,569,366)	(16,309,926)
Balance, end of year	$ 5,682,534	$ 7,578,477
c. Deferred income tax assets and liabilities		
Current		
Deferred income tax assets		
Unrealized gain on intercompany transactions	$ 85,659	$ 94,358
Severance pay	65,249	57,657
Accrued Electrostatic Precipitator dust disposal expense	31,934	-
Others	10,121	16,971
	192,963	168,986
Deferred income tax liabilities		
Temporary difference between tax reporting and financial reporting - inventory	(20,773)	(25,011)
	172,190	143,975
Noncurrent		
Deferred income tax assets		
Impairment loss on financial assets carried at cost	300,000	240,000
Impairment loss on rental assets	83,165	107,927
Cumulative effect of changes in accounting principles	64,547	-
Unrealized gain on intercompany transactions	3,694	1,547
Unrealized foreign exchange gain	(66,554)	(89,037)
Others	3,292	12,277
	388,144	272,714
Deferred income tax liabilities		
Foreign investment income	(394,568)	(323,235)
Temporary difference between tax reporting and financial reporting – depreciation methods	(2,710,265)	(2,893,576)
	(3,104,833)	(3,216,811)
	(2,716,689)	(2,944,097)
Total deferred income tax liabilities - net	$ (2,544,499)	$ (2,800,122)

(Concluded)

Under related regulations, the above tax credits resulted from certain purchases of machinery and equipment, research and development, employees' training, and investment in newly emerging, important and strategic industries.

Temporary difference for depreciation between tax reporting and financial reporting resulted from the adoption of accelerated depreciation method in the filing of income tax returns.

The Corporation's income tax returns through 2002 had been examined by the tax authorities.

d. Imputation tax system

Under the Imputation Tax System, domestic stockholders are allowed a tax credit for the income tax paid by the Corporation on earnings generated since 1998. Nonresident stockholders, including holders of overseas depository receipts, are allowed only a tax credit from the 10% income tax on undistributed earnings, which can be used to offset withholding income tax on dividends paid.

As of December 31, 2006, the balance of the imputation credit account (ICA) aggregated $2,985,419 thousand. The estimated creditable tax ratio for the 2006 earnings was 22.07%, and the actual ratio for the 2005 earnings was 29.84%.

As of December 31, 2006, undistributed earnings generated up to 1997 amounted to $35,440 thousand, which is not subject to the Imputation Tax System.

22. PERSONNEL EXPENDITURE, DEPRECIATION AND AMORTIZATION

	2006				2005			
	Cost of Revenues	Operating Expense	Others	Total	Cost of Revenues	Operating Expense	Others	Total
Personnel Expenditure								
Salary	$ 13,696,813	$ 2,295,958	$ 65,947	$ 16,058,718	$ 14,425,508	$ 2,504,219	$ 150,488	$ 17,080,215
Labor and health insurance	586,130	94,286	-	680,416	521,086	88,829	1,495	611,410
Pension and consolation costs	1,232,785	244,335	166,438	1,643,558	1,167,221	227,063	123,377	1,517,661
Others	461,656	76,018	61,251	598,925	497,379	81,214	40,973	619,566
	$ 15,977,384	$ 2,710,597	$ 293,636	$ 18,981,617	$ 16,611,194	$ 2,901,325	$ 316,333	$ 19,828,852
Depreciation	$ 9,113,997	$ 217,104	$ 26,546	$ 9,357,647	$ 9,086,337	$ 303,379	$ 29,065	$ 9,418,781
Amortization	500,561	1,137	4,161	505,859	79,712	1,260	6,548	87,520

23. EARNINGS PER SHARE

	2006		2005	
	Before Tax	After Tax	Before Tax	After Tax
Basic EPS				
Net income before cumulative effect of changes in accounting principles	$ 4.34	$ 3.57	$ 5.93	$ 4.61
Cumulative effect of changes in accounting principles	(0.01)	(0.01)	-	-
Net income	$ 4.33	$ 3.56	$ 5.93	$ 4.61
Diluted EPS				
Net income before cumulative effect of changes in accounting principles	$ 4.33	$ 3.56	$ 5.91	$ 4.60
Cumulative effect of changes in accounting principles	(0.01)	-	-	-
Net income	$ 4.32	$ 3.56	$ 5.91	$ 4.60

	Amount (Numerator)		Shares (Denominator)	Earnings Per Share (Dollars)	
	Before Tax	After Tax	(Thousand)	Before Tax	After Tax
Year ended December 31, 2006					
Net income (Net of cumulative effect of changes in accounting principles, before and after income tax of $102,369 thousand and $37,822 thousand, respectively	$ 47,576,384	$ 39,158,584			
Less: Preferred dividends	(69,301)	(56,972)			
Basic EPS					
Net income of common Stockholders	47,507,083	39,101,612	10,970,978	$ 4.33	$ 3.56
Effect of potentially dilutive shares:					
Add: Preferred dividends	69,301	56,972	40,694		
Diluted EPS					
Net income of common stockholders and effect of potentially dilutive shares	$ 47,576,384	$ 39,158,584	11,011,672	4.32	3.56
Year ended December 31, 2005					
Net income	$ 65,112,429	$ 50,646,639			
Less: Preferred dividends	(73,251)	(56,977)			
Basic EPS					
Net income of common Stockholders	65,039,178	50,589,662	10,972,069	5.93	4.61
Effect of potentially dilutive shares:					
Add: Preferred dividends	73,251	56,977	40,698		
Diluted EPS					
Net income of common stockholders and effect of potentially dilutive shares	$ 65,112,429	$ 50,646,639	11,012,767	5.91	4.60

In EPS calculation for the year ended December 31, 2005, the number of outstanding shares was retroactively adjusted for the effect of capitalization of 2005 retained earnings. Thus EPS before tax and after tax decreased from NT$6.21 to NT$4.83 and from NT$5.93 to NT$4.61, respectively.

24. RELATED-PARTY TRANSACTIONS

a. Related parties

Related Parties	Relationship with the Corporation
C. S. Aluminum Corporation (CAC)	Subsidiary
China Steel Express Corporation (CSE)	Subsidiary
China Steel Chemical Corporation (CSCC)	Subsidiary
China Steel Global Trading Corporation (CSGT)	Subsidiary
China Hi-ment Corporation (CHC)	Subsidiary
China Ecotek Corporation (CEC)	Subsidiary
China Steel Structure Corporation (CSSC)	Subsidiary
Chung Hung Steel Corporation (CHSC)	Subsidiary
China Steel Machinery Corporation (CSMC)	Subsidiary
Gains Investment Corporation (GIC)	Subsidiary
China Steel Security Corporation (CSS)	Subsidiary
China Prosperity Development Corporation (CPDC)	Subsidiary
Info-Champ Systems Corporation (ICSC)	Subsidiary
China Steel Management Consulting Corporation (CSMCC)	Subsidiary
Hi-mag Magnetic Corporation	Subsidiary
Long-Yuan-Fa Investment Corporation	Subsidiary
Horng-Yih Investment Corporation	Subsidiary
Goang-Yaw Investment Corporation	Subsidiary
Dragon Steel Corporation (DSC)	Subsidiary
China Steel Asia Pacific Holdings Pte Ltd. (CSAPH)	Subsidiary
Chung Mao Trading (BVI) Corp.	Indirect investee under Corporation's substantial control
Chung Mao Trading (SAMOA) Co.	Indirect investee under Corporation's substantial control
CSGT (Singapore) Pte. Ltd.	Indirect investee under Corporation's substantial control
Mentor Consulting Corporation	Indirect investee under Corporation's substantial control
Steel Castle Technology Corp.	Indirect investee under Corporation's substantial control
Union Steel Development Corp.	Indirect investee under Corporation's substantial control
Betacera Inc.	Indirect investee under Corporation's substantial control
Wabo Globe Trading Corporation	Indirect investee under Corporation's substantial control
Universal Exchange Inc.	Indirect investee under Corporation's substantial control
United Steel Engineering and Construction Corporation (USECC)	Indirect investee under Corporation's substantial control
Thintech Materials Technology Co., Ltd.	Indirect investee under Corporation's substantial control
Pao Good Industrial Co., Ltd.	Indirect investee under Corporation's substantial control
Ornasteel Enterprise Corp. (M) Sdn. Bhd.	Indirect investee under Corporation's substantial control
Group Steel Enterprise Corp. (M) Sdn. Bhd	Indirect investee under Corporation's substantial control
CSGT (JAPAN) Co., Ltd.	Indirect investee under Corporation's substantial control

(Continued)

Related Parties	Relationship with the Corporation
CSGT Hong Kong Limited	Indirect investee under Corporation's substantial control
CSGT (SHANGHAI) Co., Ltd.	Indirect investee under Corporation's substantial control
Ningbo Huayang Aluminum – Tech Co., Ltd	Indirect investee under Corporation's substantial control
Taiwan Rolling Stock Co., Ltd. (TRSC)	Investee
Kaohsiung Rapid Transit Corporation (KRTC)	Investee
TaiAn Technologies Corporation (TTC)	Investee
Kaohsiung Labor Assemble & Disassemble Co., Ltd.	Indirect investee under Corporation's substantial control
CSC Educational Foundation	Foundation established with Corporation's donation

b. Significant related-party transactions:

	2006		2005	
	Amount	%	Amount	%
Sales				
CHSC	$ 4,240,417	2	$ 1,140,929	1
CSSC	2,969,530	2	3,243,159	2
OEC	2,147,388	1	2,513,078	1
CSCC	1,801,268	1	1,754,811	1
Others	2,256,675	2	2,774,069	1
	$ 13,415,278	8	$ 11,426,046	6
Purchases				
CSE	$ 13,604,954	17	$ 13,220,944	16
CAC	3,112,947	4	1,784,766	2
CSGT	481,638	1	1,161,914	1
Others	589,724	1	946,407	2
	$ 17,789,263	23	$ 17,114,031	21

Sales to and purchases from related parties are made under normal terms, except those with OEC, CAC, CSCC, CHC, and CSE, for which there were no similar transactions in the market for comparison.

Assets lease

The Corporation leases its land and office to CAC, CSSC, CHC, CSCC and CSMC, etc. Rentals are calculated at 4% to 10% p.a. of land assessed value as published by the government or under normal terms. Rentals are collected semiannually, except for rentals from CAC and that from CSCC on the storage tank and pipelines, which are collected monthly. Lease information is as follows:

	Expiry Date	Rental Income 2006	Rental Income 2005
CAC	February 2016	$ 47,385	$ 47,353
CSMC	November 2011	24,597	22,959
CSCC	December 2010	18,864	19,939
CSSC	May 2018	15,717	16,054
CHC	April 2012	4,912	4,927
Others	April 2009	7,526	3,606
		$ 119,001	$ 114,838

Property transaction

In January 2005, the Corporation bought land from CPDC for office construction at the price of $834,673 thousand, which was determined by reference to appraisal report.

Other expenditures

Other expenditures paid to related parties pertained to furnace slag and clearance services, property maintenance or construction, export shipping charges, commissions for export and import services, etc., were recognized on manufacturing expenses, operating expenses and nonoperating expenses as follow:

	2006	2005
CEC	$ 2,377,107	$ 2,040,106
CSMC	1,785,416	1,260,775
CSSC	1,084,371	1,017,263
USECC	688,442	544,868
CHC	664,591	522,038
Others	1,412,643	1,346,208
	$ 8,012,570	$ 6,731,258

Donation expenditures

In 2006, the Corporation donated $200,000 thousand to CSC Educational Foundation. This foundation is established for promotion of education and personnel training in steel and related fields.

Other revenues

Other revenues pertained to labor services, processing of products, utilities, construction, and other services to related parties. These were recognized in other operating revenues and nonoperating revenues.

	2006	2005
KRTC	$ 1,561,709	$ 1,225,521
CHSC	357,625	238,711
CAC	256,862	156,169
DSC	233,972	239,535
CSCC	85,962	106,010
Others	273,235	325,852
	$ 2,769,365	$ 2,291,798

Short–term loans payable to related parties

In January 2005, the Corporation borrowed $1,238,738 thousand (USD$38,500 thousand) from CSAPH at no interest and repaid in September 2005.

c. Balances at year-end

	2006		2005	
	Amount	%	Amount	%
Receivables				
CSCC	$ 170,630	6	$ 115,473	6
CHSC	165,261	6	27,589	1
KRTC	107,675	4	22,029	1
DSC	63,741	2	166,031	8
Others	117,827	5	74,828	4
	$ 625,134	23	$ 405,950	20
Payables				
CSE	$ 1,923,696	53	$ 761,699	33
CAC	354,993	10	86,247	4
Others	46,661	1	22,561	-
	$ 2,325,350	64	$ 870,507	37

25. PLEDGED ASSETS

a. Time deposits of $3,681,694 thousand and $4,631,694 thousand as of December 31, 2006 and 2005, respectively, have been pledged mainly as collateral for bank overdraft, etc.

b. The Corporation provided machinery and equipment with carrying values of $2,431,310 thousand and $2,723,469 thousand as of December 31, 2006 and 2005, respectively, as collaterals for long-term credit lines with banks.

26. COMMITMENTS AS OF DECEMBER 31, 2006

a. The Corporation engaged in several construction contracts, under guarantees of $1,214,995 thousand granted by The Mega International Commercial Bank and Taipei Fubon Bank.

b. Unused letters of credit for purchase of raw materials and supplies amounted to $8.1 billion.

c. The Corporation entered into raw material purchase contracts with suppliers in Australia, India, Brazil, Canada, Indonesia, North Korea, Japan, Philippines, Russia and domestic companies with contract terms of 1 to 10 years. Contracted annual purchases of 8,200,000 metric tons of coal, 17,120,000 metric tons of iron ore, and 2,800,000 metric tons of limestones are at prices negotiable every year. Unpaid purchase amounts as of December 31, 2006 were US$9.7 billion (including 16,920,000 metric tons of coal; 163,150,000 metric tons of iron ore; and 220,000 metric tons of limstones).

d. CHSC entered into a syndicated credit facility agreement with The Mega International Commercial Bank and 23 other banks and another syndicated agreement with The Mega International Commercial Bank and 21 other banks. Under these agreements, the Corporation and its related parties should collectively hold at least 30% of CHSC's issued shares and have over half of CHSC's board seats as well as significant influence on its operations. As of December 31, 2006, the Corporation had total direct and indirect shareholdings in CHSC of 39% and total seats in the Board of Directors and significant influence on its operations.

e. KRTC entered into a syndicated credit facility agreement with the Taiwan Bank and 23 other banks. Under this agreement, the Corporation and its subsidiaries should collectively hold at least 30% of KRTC's capital stock during the construction period. As of December 31, 2006, the Corporation's total equity in KRTC was 31%.

27. FINANCIAL INSTRUMENTS

The Corporation had no derivative transactions for the years ended December 31, 2006 and 2005.

a. As of December 31, 2006 and 2005, the information of fair values was as follows:

	2006		2005	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Assets				
Financial assets at fair value through profit or loss	$ 12,315,988	$ 12,315,988	$ 10,975,710	$ 11,131,531
Available-for-sale financial assets	7,787,299	7,787,299	2,219,366	6,097,129
Financial assets carried at cost	5,766,315	-	6,173,510	-
Investment in bonds without quoted price	5,482,324	5,482,324	5,881,374	5,881,374
Refundable deposits	55,833	55,833	346,830	346,830
Liabilities				
Long-term bonds	13,700,000	13,865,449	10,000,000	10,034,101
Long-term bank debts	3,426,250	3,426,250	3,496,250	3,496,250

Effective 2006, the Corporation adopted the newly issued SFAS No. 34 "Accounting for Financial Instruments." Thus, some changes of fair value in financial assets were not recognized in 2005.

The cumulative effect of changes in accounting principles and the adjustment of stockholders' equity were stated in Note 3.

b. The assumptions and methods used to estimate the fair values of financial instruments are as follows:

1) The carrying values of cash and cash equivalents, notes and accounts receivable, other receivables, pledged time deposits, short-term bank loans and overdraft, notes and accounts payable and accrued expenses, approximate fair value because of the short maturities of these instruments.

2) The fair values of financial assets at fair value through profit of loss and available-for-sale financial assets are determined at their market value. If there is no market value available for reference, the fair values are determined by using valuation technique. The information used as basis for determining the Corporation's assumptions in applying valuation technique is consistent with that used by market participants. The information is obtained by the Corporation from financial institutions.

3) The fair values of long-term liabilities (including bonds payable) are determined by the present values of future cash flows, with the values discounted at the interest rates of similar long-term debts available for the Corporation.

4) The fair values of refundable deposits are determined at their carrying values.

5) The fair value of investment in bonds without quoted price is determined at their carrying values.

6) Financial assets carried at cost are financial instruments held by non-public corporation which do not have quoted market price in an active market and whose verifiable fair value cannot be determined at a reasonable cost.

c. The fair values of the Corporation's financial assets determined by either using quoted market price in an active market or valuation technique were as follows:

	Amount determined by quoted market price		Amount determined by using valuation technique	
	2006	2005	2006	2005
Assets				
Financial assets at fair value through profit or loss	$ 12,315,988	$ 10,975,710	$ -	$ -
Available-for-sale financial assets	7,536,549	1,968,666	250,750	250,700

d. There is no gain or loss for the estimated change in fair value by using valuation technique for the year ended December 31, 2006.

e. As of December 31, 2006, the financial assets and liabilities with the cash flow risk of the interest rate change were $250,750 thousand and $20,036,239 thousand, respectively. The financial liabilities with fair value risk of the interest rate change were $13,700,000 thousand.

f. The Corporation's total interest revenues and expenses (exclusive of capitalized interest) which were incurred from other than financial assets and liabilities at fair value through profit or loss were $343,746 thousand and $541,823 thousand, respectively, for the year ended December 31, 2006.

g. Financial risk information

1) Market risk

This includes fair value risk of interest rate change, exchange rate risk, and market price risk. The Corporation had long-term loans in yen to hedge the exchange rate fluctuations on its investment in yen, thus, the exchange rate risk can be hedged naturally. The Corporation issues the bonds payable with the fixed interest rate, and the fair value will be influenced by the market interest rate change. If market interest rate changes at 1% each time, the fair value of bonds payable will increase or decrease by $604,447 thousand.

The Corporation's investments in the bond funds and stocks of Taiwan Semiconductor Manufacturing Company Ltd., Advanced Material Technology Corporation, Maruichi Steel Tube Ltd, and Tang Eng Iron Works Corporation invlove market risk. Except the minor fluctuation of the bond fund's market price, if the share price of the stocks increases or decreases by $1 each time, the fair value will increase or decrease by $124,735 thousand.

2) Credit risk

Credit risk represents the potential loss that would be incurred by the Corporation if the counter-parties or third-parties breached the contracts. The Corporation's financial instruments are affected by its credit risk concentration, component, contract amounts and other receivables.

As of December 31, 2006, the Corporation's credit risks amounted to $1,334,059 thousand (including net notes and accounts receivable, other receivables and refundable deposits, net notes and accounts receivable after deducted with factoring and L/C transaction of $3,067,769 thousand) and the maximum credit risk and carrying value are the same. The credit risks of the cash and bank deposits of the Corporation were considered to be immaterial.

3) Liquidity risk

The Corporation has sufficient operating capital to meet future cash needs. Therefore, the cash flow risk is low.

Financial assets at fair value through profit or loss and available-for-sale financial assets could be sold rapidly at prices approximating fair value because those financial assets could be sold in secondary financial market at market value.

There are liquidity risks for the financial assets carried at cost and investment in bonds without quoted price because no market values are available.

4) Cash flow risk of interest rate change

Market interest rate change will influence the effective interest rate of the financial instruments (including short-term loans and overdraft) which have cash flow risk of the interest rate change, and make future cash flow fluctuate. If the market interest rate increases 1%, the Corporation's cash outflow will increase $197,855 thousand.

h. Fair value hedge

The Corporation borrowed long-term bank loans in yen to effectively hedge the exchange rate fluctuations on the investments in East Asia United Steel Corporation and Maruichi Steel Tube Ltd in yen.

	Appointed hedging instrument	
Hedged item	Financial instrument	Changes of fair value
Stock investments in Maruichi Steel Tube Ltd.	Long-term bank loans in yen	$ 14,560
Stock investments in East Asia United Steel Corporation	Long-term bank loans in yen	55,440

CHINA STEEL CORPORATION

ADDITIONAL EXPLANATION FOR ACCOUNTS IN STOCKHOLDERS' EQUITY
YEARS ENDED DECEMBER 31, 2006 AND 2005

1. ADJUSTMENT OF EQUITY IN INVESTEES DUE TO CHANGE IN PERCENTAGE OF OWNERSHIP

a. Long-term investment adjustment

When an investee's capital surplus changed, the investor should adjust its long-term stock investment account and capital surplus account based on its stockholding percentage.

b. Adjustment of equity in investee due to change in percentage of ownership

If an investee issues new shares and original stockholders do not subscribe the new shares proportionately, then the investment percentage, e.g. the equity in the investee's net assets, will change. This change shall be reflected as an adjustment of the additional paid-in capital (capital surplus) and the long-term stock investments accounts. If this adjustment is to reduce the additional paid-in capital resulting from long-term stock investments and its balance is insufficient, the difference should be adjusted to the unappropriated retained earnings.

2. UNREALIZED GAIN (LOSS) ON FINANCIAL INSTRUMENTS

Available-for-sale financial asset is measured at fair value and its value change is recorded as a reconciliation item in the stockholders' equity.

3. INVESTEES' UNRECOGNIZED NET LOSS ON PENSION COST

a. Unrecognized net loss on pension cost is the minimum pension liability exceeding the sum of unrecognized prior service cost and unrecognized transitional net benefit obligation. It is classified as a reduction of stockholders' equity.

b. Minimum pension liability, which is calculated actuarially, is the minimum amount of pension liability that is required to be recognized on the balance sheet.

c. Prior service cost is the increase in projected benefit obligation due to an employee's accumulation of service years at the initial introduction of pension data or the subsequent pension data amendment.

d. Unrecognized transitional net assets or benefit obligation means the amount resulting from a change from a method specified in Statement of Financial Accounting Standards No. 18, "Accounting for Pensions." This amount is the difference between (a) the fair market value of plan assets plus accrued pension liability or less prepaid pension cost recognized previously in the books and (b) the projected benefit obligation. If the difference is positive, it is treated as unrecognized transition net assets; if the difference is negative, it is treated as unrecognized transition net benefit obligations.

4. TRANSFER OF TREASURY STOCK TO EMPLOYEES.

Treasury stock is transferred at the price which is determined at the purchase cost plus the Corporation financial cost up to the time that the transfer is made.

When treasury stocks are transferred, if the transfer price is higher than the book value, the difference should be credited to capital surplus. If the transfer price is lower than book value, the difference should first be offset against capital surplus from the same class of treasury stock transactions, and the remainder, if any, should be debited to unappropriated retained earnings.

5. DISPOSAL OF THE CORPORATION'S SHARES HELD BY SUBSIDIARIES

A parent company should account for its outstanding stocks held by its subsidiary as treasury stocks when it recognizes investment income and prepares financial statements, and the accounting treatment is the same as that stated in item 4 above.

6. CASH DIVIDENDS DECLARED BY THE CORPORATION AND RECEIVED BY SUBSIDIARIES

When an investor receives cash dividends from available-for-sale financial assets or financial assets carried at cost or from a year after investment acquisition, it records these dividends as investment income. But if the cash dividend is from the parent company, the accounting for these dividends is the same as that for treasury stock, i.e., the investment income should be credited to capital surplus when the parent company prepares financial statements.

OWNERSHIP OF SUBSIDIARIES AND OTHER EQUITY INTERESTS

December 31, 2006

Companies	Investment Amounts[26] (NT$1,000)	Holding Ratio (%)
Long-term stock investments - equity method:		
Dragon Steel Corporation	15,731,795	47
Gains Investment Corporation	8,788,400	100
China Steel Express Corporation	8,631,926	100
C.S. Aluminum Corporation	7,387,741	100
China Prosperity Development Corporation	4,680,646	100
Kaohsiung Rapid Transit Corporation	3,035,260	31
Chung Hung Steel Corporation[27]	2,759,685	24
China Steel Asia Pacific Holdings Pte Ltd[28]	2,683,091	100
China Steel Chemical Corporation	1,226,692	30
China Steel Global Trading Corporation	1,193,585	100
China Steel Machinery Corporation	861,088	100
China Hi-ment Corporation	656,151	20
Info-Champ Systems Corporation	644,834	100
Horng Yih Investment Corporation	632,007	99
Long Yuan Fa Investment Corporation	630,272	99
Goang Yaw Investment Corporation	615,244	99
China Steel Structure Co., Ltd.	499,023	18
China Ecotek Corporation	373,658	36
Kaohsiung Arena Development Corporation	260,606	18
China Steel Security Corporation	250,071	100
Taiwan Rolling Stock Co., Ltd.	226,194	22
HIMAG Magnetic Corporation	94,324	50
Baolai Greeting Development Co., Ltd	50,136	45
China Steel Management Consulting Corporation	9,458	38
TaiAn Technologies Corporation	4,136	17
Less: shares held by subsidiaries accounted for as treasury stock	(1,295,361)	
Subtotal	60,630,662	
Financial assets carried at cost:		
Industrial Bank of Taiwan	1,000,000	4
CDIB & Partners Investment Holding Corporation	500,000	5
CDIB Bio Science Ventures I, Inc.	102,000	5
Hsin Hsin Cement Enterprice Corp.	75,760	9
Phalanx Biotech Group	73,370	10
Overseas Investment & Development Corporation	50,000	6
CTB I Venture Capital Co., Ltd	50,000	5
Asia Pacific Broadband Telecom Co., Ltd.	0	2
East Asia United Steel Corporation - preferred stock A	2,741,000	29
Dragon Steel Corporation – preferred stock A	999,877	100
Sino-Canada Biotechnology Development Fund, LP	174,308	17
Subtotal	5,766,315	
Investment in bonds without quoted price:		
Taiwan High Speed Rail Corporation - preferred stock C	4,297,940	19
Taiwan High Speed Rail Corporation - preferred stock B	884,384	4
Taigen Biotechnology Co., Ltd. - preferred stock B	300,000	24
Subtotal	5,482,324	
Available-for-sale financial assets:		
Maruichi Steel Tube Ltd.	757,920	2
Allied Material Technology Corporation	243,290	2
Tang Eng Iron Works Co., Ltd.	0	9
Adjustments for change in value	1,850,767	
Subtotal	2,851,977	
Total	74,731,278	

[26] Invested amounts are based on balances in the account Long-term Investments.

[27] The Corporation's total equity in Chung Hung Steel Corporation was 39%, of which 24% was directly owned and 15% was indirectly owned through Goang Yao, Horng Yih and Long Yuan Fa.

[28] Through China Steel Asia Pacific Holding Pte Ltd. the Corporation indirectly holds 47%, 47% and 6% of Ornasteel Enterprise Corporation (M) Sdn. Bhd., Group Steel Corporation (M) Sdn. Bdh., and Wuxi Teco Electric & Machinery Co., Ltd. respectively.

MAIN BUSINESSES AND ADDRESSES OF SUBSIDIARIES AND OTHER CSC-INVESTED COMPANIES

(As of March 20, 2007)

SUBSIDIARIES

C. S. Aluminium Corporation
Chairman: C. C. Chen
President: S. T. Chang
Main business: aluminum products
Address: 17 Tong Lin Road, Siaogang District, Kaohsiung 81260, Taiwan, R.O.C.
Tel: 886-7-871-8666
Fax: 886-7-872-1852

China Steel Express Corporation
Chairman: Y. C. Chen
President: Donald K. L. Chao
Main businesses: marine cargo transportation; purchase, sale and chartering of vessels; and shipping agency
Address: 32F, 8 Ming Chuan 2nd Road, Chien Chen District, Kaohsiung 80658, Taiwan, R.O.C.
Tel: 886-7-337-8888
Fax: 886-7-338-1310

China Steel Chemical Corporation
Chairman: Y. C. Chiang
President: P.Y. Chen
Main business: coal tar chemicals
Address: 5F-1, 47 Chunghua 4th Road, Ling Ya District, Kaohsiung 80245, Taiwan, R.O.C.
Tel: 886-7-338-3515
Fax: 886-7-338-3516

China Steel Global Trading Corporation
Chairman: Y. C. Chiang
President: K. M. Chen
Main businesses: import / export
Address: 31F, 8 Ming Chuan 2nd Road, Chien Chen District, Kaohsiung 80658, Taiwan, R.O.C.
Tel: 886-7-332-2168
Fax: 886-7-335-6411~2

China Hi-ment Corporation
Chairman: R. S. Jong
President: S. Y. Chiang
Main businesses: pulverized blast furnace slag and slag cement
Address: 10F, 243 Yi-Hsin 1st Road, Chien Chen District, Kaohsiung 80652, Taiwan, R.O.C.
Tel: 886-7-336-8377
Fax: 886-7-336-8433

China Ecotek Corporation
Chairman: K. L. Du
President: F. L. Hong
Main businesses: engineering, design and construction of environmental protection installations
Address: 8F, 8 Ming Chuan 2nd Road, Chien Chen District, Kaohsiung 80658, Taiwan, R.O.C.
Tel: 886-7-330-6138
Fax: 886-7-339-4016

Chung Hung Steel Corporation
Chairman: T. H. Chen
President: J. G. Liu
Main business: hot rolled steel products
Address: 317 Yu-Liao Road, Chiao Tou, Kaohsiung 82544, Taiwan, R.O.C.
Tel: 886-7-611-7171
Fax: 886-7-611-0594

China Steel Structure Co., Ltd.
Chairman: J. Y. Chen
President: S. J. Su
Main businesses: steel structures, construction
Address: 1 Chung Kang Road, Siaogang District, Kaohsiung 81233, Taiwan, R.O.C.
Tel: 886-7-802-3433
Fax: 886-7-801-9150

China Steel Machinery Corporation
Chairman: T. S. Kao
President: W. D. Hsu
Main businesses: machinery manufacturing
Address: 3 Taichi Road, Siaogang District, Kaohsiung 81246, Taiwan, R.O.C.
Tel: 886-7-802-0111
Fax: 886-7-803-3515