

China Steel Corporation

**Financial Statements for the
Nine Months Ended September 30, 2006 and 2005
And Independent Accountants' Review Report**

INDEPENDENT ACCOUNTANTS' REVIEW REPORT

The Board of Directors and Stockholders
China Steel Corporation

We have reviewed the accompanying balance sheets of China Steel Corporation (the "Corporation") as of September 30, 2006 and 2005, and the related statements of income and cash flows for the nine months then ended. These financial statements are the responsibility of the Corporation's management. Our responsibility is to issue a report on these financial statements based on our reviews.

Except as stated in the following paragraph, we conducted our reviews in accordance with Statement of Auditing Standards No. 36 - "Review of Financial Statements" issued by the Auditing Committee of the Accounting Research and Development Foundation of the Republic of China. A review consists principally of applying analytical procedures to financial data and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with auditing standards generally accepted in the Republic of China, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

As stated in Note 11 to the accompanying financial statements, we did not review the financial statements of certain investees (with no publicly traded stocks) in which the Corporation's long-term stock investments were accounted for by the equity method. The aggregate carrying values of these long-term stock investments were NT\$53,597,222 thousand and NT\$49,159,227 thousand as of September 30, 2006 and 2005, respectively. The related investment incomes were NT\$5,819,238 thousand and 4,220,980 thousand for the nine months ended September 30, 2006 and 2005, respectively. These investment amounts as well as the investees' information in Note 27 were based on the investees' unreviewed financial statements for the same reporting periods as those of the Corporation.

Based on our reviews, except for the effects of any adjustments that might have been determined to be necessary had certain investees' financial statements mentioned in the preceding paragraph been reviewed, we are not aware of any material modifications that should be made to the accompanying financial statements for them to be in conformity with the Guidelines Governing the Preparation of Financial Reports by Securities Issuers and accounting principles generally accepted in the Republic of China.

As stated in Note 3 to the accompanying financial statements, the Corporation adopted, effective 2006, the newly issued Statements of Financial Accounting Standards ("Statements") No. 34 - "Accounting for Financial Instruments" and No. 36 - "Disclosure and Presentation of Financial Instruments" and the related revisions of previously released Statements.

October 13, 2006

			LIABILITIES AND STOCKHOLDERS' EQUITY			2006		2005	
%		2005				Amount	%	Amount	%
		Amount							

CHINA STEEL CORPORATION

STATEMENTS OF INCOME

NINE MONTHS ENDED SEPTEMBER 30, 2006 AND 2005

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

(Reviewed, Not Audited)

	2006		2005	
	Amount	%	Amount	%
REVENUES	\$ 127,830,181	100	\$ 145,120,842	100
COST OF REVENUES	<u>99,557,849</u>	<u>78</u>	<u>86,220,722</u>	<u>60</u>
GROSS PROFIT	28,272,332	22	58,900,120	40
REALIZED (UNREALIZED) GAIN ON INTERCOMPANY TRANSACTIONS	<u>139,013</u>	<u>-</u>	<u>(514,990)</u>	<u>-</u>
REALIZED GROSS PROFIT	<u>28,411,345</u>	<u>22</u>	<u>58,385,130</u>	<u>40</u>
OPERATING EXPENSES				
Selling	1,701,637	1	1,713,440	1
General and administrative	1,446,520	1	2,060,548	1
Research and development	<u>789,338</u>	<u>1</u>	<u>852,744</u>	<u>1</u>
Total operating expenses	<u>3,937,495</u>	<u>3</u>	<u>4,626,732</u>	<u>3</u>
OPERATING INCOME	<u>24,473,850</u>	<u>19</u>	<u>53,758,398</u>	<u>37</u>
NONOPERATING INCOME AND GAINS				
Interest	252,020	-	436,945	-
Investment income under the equity method	7,627,871	6	5,227,546	4
Gain on appraisal of financial assets	121,313	-	378,419	-
Other	<u>984,258</u>	<u>1</u>	<u>1,046,859</u>	<u>1</u>
Total nonoperating income and gains	<u>8,985,462</u>	<u>7</u>	<u>7,089,769</u>	<u>5</u>
NONOPERATING EXPENSES AND LOSSES				
Interest	422,257	-	553,507	-
Impairment losses on long - term investments	32,000	-	906,000	1
Loss on physical inventory	173,907	-	-	-
Other	<u>516,213</u>	<u>1</u>	<u>713,661</u>	<u>-</u>
Total nonoperating expenses and losses	<u>1,144,377</u>	<u>1</u>	<u>2,173,168</u>	<u>1</u>
INCOME BEFORE INCOME TAX	32,314,935	25	58,674,999	41
INCOME TAX	<u>5,608,351</u>	<u>4</u>	<u>12,923,453</u>	<u>9</u>

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CHINA STEEL CORPORATION

STATEMENTS OF INCOME

NINE MONTHS ENDED SEPTEMBER 30, 2006 AND 2005

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

(Reviewed, Not Audited)

	<u>2006</u>		<u>2005</u>	
	Amount	%	Amount	%
INCOME BEFORE CUMULATIVE EFFECT OF CHANGES IN ACCOUNTING PRINCIPLES	\$ 26,706,584	21	\$ 45,751,546	32
CUMULATIVE EFFECT OF CHANGES IN ACCOUNTING PRINCIPLES (NET OF \$64,547 THOUSAND INCOME TAX BENEFIT)	<u>(37,822)</u>	<u>-</u>	<u>-</u>	<u>-</u>
NET INCOME	<u>\$ 26,668,762</u>	<u>21</u>	<u>\$ 45,751,546</u>	<u>32</u>
	<u>2006</u>		<u>2005</u>	
	Before Tax	After Tax	Before Tax	After Tax
EARNINGS PER SHARE				
Basic	\$ 2.93	\$ 2.43	\$ 5.34	\$ 4.17
Diluted	2.93	2.42	5.33	4.15

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

	<u>2006</u>	<u>2005</u>
Income before cumulative effect of changes in accounting principles	\$ 27,020,093	\$ 46,071,330
Net income	26,982,271	46,071,330
Basic earnings per share based on the weighted-average number of outstanding common shares aggregating 11,052,155 thousand shares and 11,053,738 thousand shares in the nine months ended September 30, 2006 and 2005, respectively	<u>\$ 2.44</u>	<u>\$ 4.16</u>
Diluted earnings per share based on the weighted-average number of outstanding common shares aggregating 11,092,852 thousand shares and 11,094,449 thousand shares in the nine months ended September 30, 2006 and 2005, respectively	<u>\$ 2.43</u>	<u>\$ 4.15</u>

The accompanying notes are an integral part of the financial statements.

(With Deloitte & Touche review report dated October 13, 2006)

(Concluded)

CHINA STEEL CORPORATION

STATEMENTS OF CASH FLOWS

NINE MONTHS ENDED SEPTEMBER 30, 2006 AND 2005

(In Thousands of New Taiwan Dollars)

(Reviewed, Not Audited)

	2006	2005
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	\$ 26,668,762	\$ 45,751,546
Adjustments		
Depreciation	6,833,340	7,144,722
Amortization	368,130	85,721
Deferred income tax	(153,412)	(112,902)
Investment income under the equity method	(7,627,871)	(5,227,546)
Loss (gain) on disposal of properties	24,618	(4,917)
Cash dividends from long-term investments under the equity method	4,956,820	5,309,653
Construction dividends from investment in bonds without quoted market prices	-	102,951
Gain on appraisal of financial assets	(121,313)	(378,006)
Impairment loss on financial assets carried at cost	32,000	906,000
Unrealized loss (gain) on intercompany transactions	(139,013)	514,990
Effects of exchange rate changes on foreign-currency long-term debts	(83)	(175,240)
Others	77,012	106,835
Net changes in operating assets and liabilities		
Notes receivable	423,087	(70,286)
Accounts receivable	(1,142,981)	(475,416)
Inventories	3,120,354	(8,133,078)
Other receivable	(188,006)	(703,455)
Other current assets	66,231	(701,986)
Notes and accounts payable	537,360	(603,639)
Accrued expenses	(120,708)	(572,053)
Other payables	516,648	170,522
Income tax payable	(1,909,220)	(3,260,837)
Other current liabilities	<u>(1,737,352)</u>	<u>(426,863)</u>
Net cash provided by operating activities	<u>30,484,403</u>	<u>39,246,716</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of financial assets at fair value through profit or loss	(9,173,380)	(13,990,000)
Disposal of financial assets at fair value through profit or loss	15,917,079	25,641,024
Increase in long-term investments under the equity method	(365,313)	(13,691,340)
Acquisition of properties	(9,029,156)	(11,020,304)
Increase in other assets	(2,751,001)	(270,778)
Proceeds of disposal of properties	1,836	86,176
Proceeds of capital reduction on financial assets carried at cost	18,000	-
Decrease in refundable deposits	244,892	-

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CHINA STEEL CORPORATION

STATEMENTS OF CASH FLOWS

NINE MONTHS ENDED SEPTEMBER 30, 2006 AND 2005

(In Thousands of New Taiwan Dollars)

(Reviewed, Not Audited)

	2006	2005
Increase in investment in bonds without quoted market prices	\$ -	\$ (3,199,944)
Proceeds of disposal of long-term investments	-	54,170
Decrease in pledged time deposits	-	100,000
Net cash used in investing activities	<u>(5,137,043)</u>	<u>(16,290,996)</u>
CASH FLOWS FROM FINANCING ACTIVITIES		
Cash dividends	(39,694,019)	(38,668,242)
Decrease in commercial paper payable	(1,499,376)	(1,799,052)
Increase in short-term bank loans and overdraft	6,443,101	6,245,402
Increase in long-term loans	8,100,000	977,790
Bonus to employees	(915,350)	(714,035)
Remuneration to directors and supervisors	(137,302)	(138,243)
Repayment of bonds payable	(5,000,000)	-
Acquisition of treasury stock	<u>(32,096)</u>	<u>-</u>
Net cash used in financing activities	<u>(32,735,042)</u>	<u>(34,096,380)</u>
NET DECREASE IN CASH AND CASH EQUIVALENTS	(7,387,682)	(11,140,660)
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	<u>17,739,481</u>	<u>26,402,765</u>
CASH AND CASH EQUIVALENTS, END OF PERIOD	<u>\$ 10,351,799</u>	<u>\$ 15,262,105</u>
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Interest paid	\$ 369,263	\$ 286,472
Income tax paid	7,670,983	16,297,192
PURCHASE OF PROPERTIES		
Acquisition of properties	\$ 11,157,068	\$ 11,104,031
Increase in payable on properties purchased	<u>(2,127,912)</u>	<u>(83,727)</u>
	<u>\$ 9,029,156</u>	<u>\$ 11,020,304</u>

The accompanying notes are an integral part of the financial statements.

(With Deloitte & Touche review report dated October 13, 2006)

(Concluded)