

Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion and analysis should be read in conjunction with our financial statements together with the accompanying notes, included elsewhere in this annual report. The financial statements have been prepared in accordance with accounting principles generally accepted in Hong Kong ("HK GAAP"), which differ in certain material respects from the generally accepted accounting principles in the United States ("U.S. GAAP"). A discussion of the material differences is contained under the heading "Supplementary Information".

Overview

The Group is engaged principally in alumina refining and primary aluminum smelting operations. We organise and manage our operations according to the following business segments:

- Alumina segment, which consists of mining and purchasing bauxite and other raw materials, refining bauxite into alumina, and selling alumina both internally to the Group's primary aluminum smelters and externally to customers outside the Group. To a lesser extent, this segment also includes the production and sales of alumina hydrate, alumina chemicals and gallium.
- Primary aluminum segment, which consists of procuring alumina and other raw materials, supplemental materials and electricity, smelting alumina to produce primary aluminum, and selling substantially all primary aluminum products to external customers. In addition, this segment includes production and sales of carbon products.
- Corporate and other services segment, which includes the headquarters' operations, research conducted by the Group's research institutes and provision of the Group's research and development services to third parties.



Guo Shengkun
Chairman, President
and CEO



Xiong Weiping
Executive Director and
Senior Vice President



Luo Jianchuan
Vice President



Song Peikai
Vice President



Zhang Chengzhong
Vice President



Chen Jihua
Vice President and CFO

Management's Discussion and Analysis of Financial Condition and Results of Operations *(Continued)*

Results of Operations

The Group's profit amounted to RMB3,552.0 million for the year ended December 31, 2003, representing an increase of RMB2,150.4 million, up 153.4%, from the previous year's RMB1,401.6 million. The increase was mainly attributable to a significant increase in prices of the Group's principal products such as alumina and primary aluminum and the increased sales volume of alumina.

Revenues

The Group's total revenues amounted to RMB23,826.0 million for the year ended December 31, 2003, representing an increase of RMB6,510.4 million, up 37.6%, from the previous year's RMB 17,315.6 million. Total revenues include sales of goods and other revenues. Sales of goods accounted for 97.0% and 97.6% of the Group's total revenues for the years ended December 31, 2002 and 2003, respectively. The Group's sales of goods increased by 38.4 % from RMB 16,792.8 million for the year ended December 31, 2002 to RMB23,245.9 million for the year ended December 31, 2003, representing an increase of RMB6,453.1 million. The increase was primarily due to the significant increase in selling prices of the Group's principal products such as alumina and primary aluminum, and a growth in sales volume of alumina was also a major contributor to the increased revenue of the Group. For 2003, the Group's average external selling price for alumina reached RMB 2,407.7 per tonne (tax excluded, similarly hereinafter), representing an increase of RMB 758.0 per tonne or 45.9% from RMB 1,649.7 per tonne for the previous year.

The Group's average external selling price for primary aluminum reached RMB 12,460.5 per tonne, representing an increase of RMB 960.3 per tonne or 8.4% from RMB 11,500.2 per tonne for the previous year. The Group's external sales volume of alumina increased by 12.8% from 3,740,500 tonnes for the year ended December 31, 2002 to 4,219,600 tonnes for the year ended December

31, 2003. The Group's external sales volume of primary aluminum decreased by 1.5% from 758,600 tonnes for the year ended December 31, 2002 to 746,900 tonnes for the year ended December 31, 2003.

Cost of Sales

The Group's total cost of sales increased by 23.1% from RMB13,349.5 million in 2002 to RMB 16,439.5 million in 2003. The increase was mainly attributable to a growth in sales volume of alumina, and the increased unit costs of primary aluminum and alumina caused by the increase in raw material prices compared to 2002.

Selling and Distribution Expenses

The Group's selling and distribution expenses increased by RMB47.6 million from RMB 501.8 million in 2002 to RMB549.4 million in 2003, up 9.5%, which was primarily attributable to the increase in sales volume of alumina. But the Group has been successful in controlling the relative increase in selling and distribution expenses for 2003 at a level that is lower than the increase in sales, due to a combination of higher average selling prices for the Group's products and the effect of the rationalization and consolidation of the Group's sales channels.

General and Administrative Expenses

General and administrative expenses increased by 42.8% from RMB 733.8 million in 2002 to RMB1,047.5 million in 2003. The increase was mainly due to the recovery of the accounts receivable in 2002 for the years prior to 1999, which resulted in a net write-back of provisions for doubtful accounts of RMB97.1 million, reducing general and administrative expenses accordingly; and a rise of RMB 55.0 million in taxation and surcharges which were levied by the PRC, due to the increased revenue for the year. In addition, owing to overfulfilment of operational targets set for 2003, the wages and welfare expenditure of management staff increased by RMB 136.2 million under the Group's incentive compensation program.

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Research and Development Expenses

The Group's research and development expenses increased by 31.5% from RMB 131.9 million in 2002 to RMB173.4 million in 2003. The increase was primarily due to the centralization of research and development activities undertaken at each plant in the Group's research and development center. The Group focuses its research and development efforts on important projects and will continue to make appropriate investments in its research and development.

Other Income / Expenses

The Group's expenses (net of other income) increased from a net expense of RMB 16.09 million in 2002 to a net expense of RMB 25.54 million in 2003. This was attributable to RMB65.21 million of realized and unrealized losses on futures contracts in 2003, being partially offset by a gain of RMB44.48 million relating to an agreement reached with China Construction Bank for payment of outstanding principal and waiver of interest payable by the Company.

Operating Profit

The Group's operating profit increased by 139.2 % from RMB 2,122.7 million in 2002 to RMB5,078.5 million in 2003. The Group's operating profit as a percentage of sales of goods increased from 12.6% in 2002 to 21.8 % in 2003.

Finance Costs

The Group's finance costs decreased by RMB39.2 million, or 8.0 %, from RMB 490.6 million in 2002 to RMB451.4 million in 2003. The decrease was mainly attributable to a reduction in average interest rate on bank loans for the Group. In addition, the Group expedited the collection of accounts receivable so that the level of the Group's working capital borrowings was reduced.

Income Taxes

The Group's income tax expense increased from RMB 183.4 million in 2002 to RMB918.9 million in 2003, which was mainly attributable to the increased profit of the Group. The Group's effective income tax rate was 19.9% in 2003, which was lower than the statutory tax rate of 33.0%. This was mainly because three branches of the Company situated in Guizhou Province, Pingguo County and Qinghai Province in the western region of the PRC were entitled to a preferential income tax rate of 15.0% in connection with the national policy to develop the western region. In addition, a subsidiary in Shandong is taxed at a preferential rate of 15.0% as it is classified as a "High-tech" enterprise in its province for tax purposes. With the approval from the State Tax Bureau, the Company's Zhongzhou branch used its tax loss of RMB 139.8 million brought forward from years prior to the Group reorganisation to set off against the current income tax expense. Certain of the Group's plants are also entitled to preferential income tax treatment for the purchase of domestically-produced equipment in investment projects.

Minority Interests

Minority interests increased from RMB 46.82 million in 2002 to RMB 157.37 million in 2003 primarily as a result of the increase in the profit of one of the Company's subsidiaries, Shandong Aluminum Industry Co., Ltd., which has minority interests.

Net Profit for the Year

As a result of the foregoing, the Group's net profit for the year increased by 153.4% from RMB1,401.6 million in 2002 to RMB3,552.0 million in 2003.

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Discussion of Segment Operations

Revenue by Segment

Alumina Segment

Sales of Goods

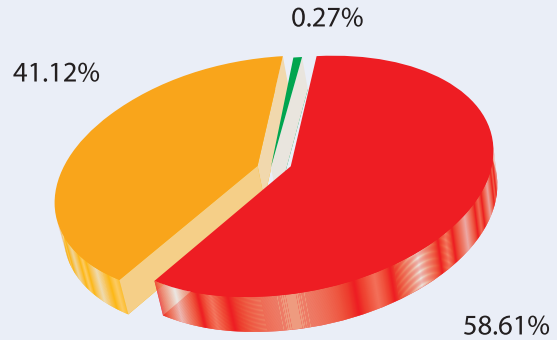
The Group's total sales of Goods of the alumina segment increased by RMB5,679.6 million to RMB15,459.2 million in 2003, up 58.1% from RMB9,779.6 million in 2002.

The Group sold alumina products to its smelters and to other domestic smelters.

Revenues from the external sales of alumina in 2003 rose by RMB4,868.6 million, up 65.3% compared with 2002, mainly due to an increase in selling price and external sales volume of alumina. Selling price of alumina in 2003 increased to RMB 2,407.7 per tonne from RMB 1,649.7 per tonne in 2002, mainly due to strong domestic demand for alumina driven by the rapidly expanding aluminum production capacity in China. The external sales volume of alumina increased by 12.8 % to 4,219,600 tonnes in 2003 from 3,740,500 tonnes in 2002, mainly attributable to the fact that the Company's production capacity for alumina increased to 5.95 million tonnes in 2003 from 5.18 million tonnes in 2002, including the commencement of operations at the end of June 2003 of the 400,000-ton alumina production line at Pingguo Phase II.

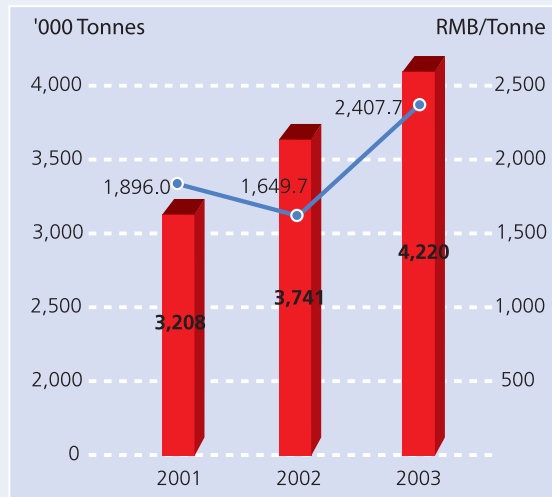
Revenues from the sales of alumina to the Group's smelters in 2003 rose by RMB 811.0 million, up 34.9% from 2002, primarily due to the increase in the Group's internal sales volume by 2.7% to 1,425,100 tonnes in 2003 from 1,387,800 tonnes in 2002. The Group's internal sales volume of alumina as a percentage of the total sales volume of alumina dropped from 27.1% in 2002 to 25.2 % in 2003.

Revenue by segment



- Alumina Segment
- Primary aluminum segment
- Corporate and other Service Segment

Alumina



- External sales volume
- The Company's alumina selling price

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Cost of Goods Sold

The total alumina segment cost of goods sold of the Group in 2003 increased by RMB 1,906.9 million, up 24.8% compared with that of 2002. The increase was mainly attributable to a growth in sales volume of alumina products, and to the increased unit production cost of alumina caused by the rising prices of raw materials. However, the Group's operations achieved better technical efficiency than in 2002, leading to the decrease in consumption rate, which partially offset the influence imposed by the rising prices of certain raw materials.

Operating Profit

Total operating profit for the alumina segment increased by 270.4% from RMB 1,379.6 million in 2002 to RMB 5,109.5 million in 2003 primarily as a result of a 58.1% increase in turnover of this segment. The operating profit of the alumina segment as a percentage of the Group's sales of goods increased from 14.1% in 2002 to 33.1% in 2003.

Primary Aluminum Segment

Sales of Goods

The Group's total sales of goods for the primary aluminum segment increased by RMB 1,577.5 million to RMB 10,845.6 million in 2003, up 17.0% over 2002. This was mainly attributable to an increase in the average selling price for primary aluminum. The increase of sales is also attributable to a change in product mix to higher value-added aluminum products.

Cost of Goods Sold

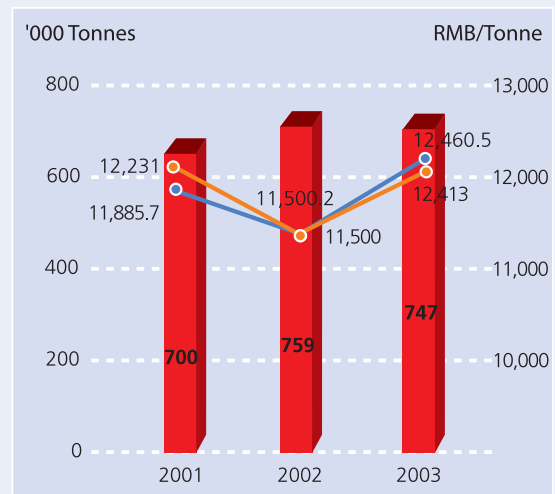
The total cost of goods sold for the Group's primary aluminum segment increased by 25.1% from RMB 7,902.5 million in 2002 to RMB 9,884.0 million in 2003, mainly due to substantial increases in the production cost of primary aluminum owing to the increase of the average alumina selling price by 45.9%. However, the Group continues to upgrade its production facilities to improve production efficiency, meanwhile, the Group

adopted an analytical management measure on production to prevent unnecessary consumption, which led to a reduction in material consumption for each tonne of primary aluminum.

Operating Profit

Operating profit of the primary aluminum segment decreased by 61.1% from RMB 1,143.7 million in 2002 to RMB 445.2 million in 2003, primarily because the increase in costs of goods sold exceeds that of the selling price. The operating profit of the Group's primary aluminum segment as a percentage of that segment's sales of goods decreased from 12.3% in 2002 to 4.1% in 2003.

Primary Aluminum



- External sales volume
- The Company's primary aluminum selling price
- Shanghai Futures Exchange average three-month aluminum futures price

Corporate and Other Services Segment

The Group's corporate and other services segment reflected the expenses for the Company's headquarters and research and development services and profit from product sales of the Group's research institute to external customers. This segment recorded an operating loss of RMB 78.34 million for the year ended December 31, 2003.

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Working Capital, Liabilities and Capital Commitments

As of December 31, 2003, the Group's current assets amounted to RMB8,638.6 million, representing an increase of RMB80.6 million from the previous year's RMB8,558.0 million. The increase was mainly attributable to: an increase of RMB 869.1 million in inventories due to the expanded production and trade scale; a reduction of RMB 1,128.0 million in accounts receivable and an increase of RMB300.4 million in cash due to the favourable market and collection of trade receivables.

As of December 31, 2003, the Group's current liabilities amounted to RMB 10,271.4 million, representing a decrease of RMB 737.5 million from the previous year's RMB11,008.9 million. The decrease was mainly attributable to repayment of certain short-term loans including current portion of long-term loans and accounts and other payables, which resulted in a decrease of RMB486.1 million and RMB447.0 million, respectively, from the previous year. A portion of the above decrease was offset by the increase in taxation payable of RMB195.6 million due to the increase in profit in 2003.



— Inventory Turnover Days
— Accounts Receivable Turnover Days

As of December 31, 2003, the Group's long-term loans amounted to RMB 5,412.6 million, representing an increase of RMB 463.3 million from the previous year's RMB4,949.3 million. The increase was mainly attributable to an increase in the Group's borrowings to finance capital expenditures.

The Group's gearing ratio (the ratio of total liabilities to the sum of total liabilities and owner's equity) decreased to 34.9% as of December 31, 2003 from 39.3% as of December 31, 2002, which is mainly attributable to an increase in retained profit.

In view of the Group's credibility and the availability of funds in the PRC, the Group currently does not foresee significant difficulties in obtaining bank loans. The Company plans to finance its capital expenditure projects and related expenditures principally through cash provided by operating activities, long-term debt and the remaining net proceeds from the Global Offering. The Group has also established standby credit facilities with domestic banks for an aggregate of RMB 28,308.0 million to finance any funding shortfall related to its alumina and primary aluminum projects and for relevant working capital purposes.

Capital Commitments

As of December 31, 2003, the Group's capital commitments amounted to RMB 16,250.9 million, which mainly consists of the Company's proposed investment in the expansion of alumina and primary aluminum production lines. Major projects include Zhongzhou 300,000-ton alumina ore-dressing Bayer Project, Guizhou technical upgrading project, Shanxi-Huaze Aluminum & Power 280,000-ton project and other production facilities upgrading projects.

Cash and Cash Equivalents

Cash and cash equivalents of the Group as of December 31, 2003 (including foreign currency-denominated deposits) totalled RMB2,596.4 million, comprising US\$ 32.47 million and HK\$ 16.37 million.

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Net Cash Flow from Operating Activities

Net cash from operations increased by 124.7% from RMB 2,671.8 million for the year ended December 31, 2002 to RMB 6,002.5 million for the year ended December 31, 2003. The increase was primarily the result of increase in selling prices of alumina and primary aluminum, and increase in external sales volume of alumina. Of the net cash from operations for the year ended December 31, 2002, RMB 600.8 million was used for interest payment and RMB 826.5 million was used to pay PRC income tax.

Cash Flows from Investing Activities

The Group's cash outlays for capital expenditure projects amounted to RMB 3,894.2 million and RMB 5,352.8 million for the years ended December 31, 2002 and 2003, respectively. The capital expenditure in 2003 contributed to the increased alumina capacity amounting to 770,000 tonnes.

Cash Flows from Financing Activities

Net cash out flows from financing activities amounted to RMB 306.9 million in 2003. The Company declared dividends of RMB 472.5 million, partially offset by contributions of Chinalco of RMB85.5 million and by minority shareholders of RMB80.6 million.

Foreign Exchange Rate Risk

The Group conducts its business primarily in Renminbi.

Renminbi is not a freely convertible currency. The restrictions on foreign exchange imposed by the PRC government may result in the material differences between future exchange rate and the current exchange rate or historical exchange rate. The Group believes that it is able to obtain sufficient foreign exchange for the performance of its relevant obligations.