

8. The Group is focused to expedite the completion of the Section 404 internal control compliance project. In accordance with the requirements under Section 404 of the Sarbanes — Oxley Act, the Company has set up a project management office and task force team, which is responsible for the design, implementation testing and evaluation of the Company's internal controls over financial reporting, including, among others, the establishment and implementation of anti-fraud and risk management programs. The Company is currently implementing and improving the newly established internal control system, and evaluating its operation effectiveness as well as remediating identified deficiencies. At the same time, it is also in the process of finalizing its evaluating documentation in accordance with the requirements under Section 404.
9. ERP information system aims to facilitate the integrated management of finance and operation, and to provide a unified platform for the centralised management of the Company. Currently, all hardware and related environment have been set up at all locations; all branches and certain subsidiaries are online.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATION

The following discussion and analysis should be read in conjunction with the Group's financial information together with the notes thereto as contained elsewhere in the interim report. The condensed interim consolidated financial information has been prepared in accordance with HK GAAP, which may materially differ in certain respects from US GAAP. A discussion of the material differences is set out in the supplementary information of the interim report.

OVERVIEW

The Group is engaged principally in alumina refining and primary aluminum smelting. The Group organizes and manages its 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. This segment also includes the production and sales of alumina chemicals (including alumina hydrate and alumina chemical products), and gallium.
- Primary aluminum segment, which consists of procuring alumina and other raw materials, supplemental materials and electricity, production and selling of almost all primary aluminum to external customers. In addition, this segment includes production and sales of carbon products and small amount of aluminum-fabricated products.
- Corporate and other services segment, which includes the headquarter's operations, research conducted by the Group's research institutes, provision of the Group's research and development services and product sales to third parties.

RESULTS OF OPERATION

The Group's net profit amounted to RMB6,744 million in the first half of 2006, representing an increase of RMB3,190 million from RMB3,554 million for the same period last year.

REVENUE

The Group's turnover increased from RMB17,849 million in the first half of 2005 to RMB27,401 million in the first half of 2006, representing an increase of RMB9,552 million or 53.5%. The increase was primarily due to the increase in external sales volume and the increase in selling prices of alumina and primary aluminum.

In the first half of 2006, the Group's sales volume of primary aluminum reached 683,100 tonnes, representing an increase of 257,300 tonnes or 60.4% from 425,800 tonnes of the first half of 2005. The increase was primarily attributable to the commencement of operation of primary aluminum in Shanxi-Huaze Aluminum & Power Co., Limited ("Shanxi Huaze"), the increase of output of primary aluminum due to the acquisition of Huasheng Aluminum and Fushun Company, and the increase of production efficiency through technological renovation of existing production lines. The increased sales volume of primary aluminum led to an increase of approximately RMB4,524 million in revenue.

The external sales volume of alumina increased from 2,691,800 tonnes in the first half of 2005 to 2,942,100 tonnes in the first half of 2006, representing an increase of 250,300 tonnes or 9.3%. The increase was mainly attributable to the increase of output resulting from the commencement of operation of the 800,000 tonnes-capacity alumina production line in phase III of Shanxi and the 700,000 tonnes-capacity alumina production line in Henan in 2006. The increased external sales volume of alumina led to an increase of RMB991 million in revenue.

Due to the increase in selling price of primary aluminum, the Group's average external selling price of primary aluminum increased by RMB3,354.68 per tonne or 23.6% from RMB14,227.25 per tonne (VAT excluded, similarly hereinafter) in 2005 to RMB17,581.93 per tonne in the first half of 2006. The increase in selling price led to an increase of RMB1,428 million in revenue.

In the first half of 2006, the Group's average external selling price of alumina reached RMB3,961.31 per tonne, representing an increase of RMB740.07 per tonne or 23% from RMB3,221.24 per tonne. The increase of selling price led to an increase of RMB1,992 million in revenue.

Revenue of the Group's alumina chemicals, carbon and other products increased by approximately RMB500 million in the first half of 2006 compared to the corresponding period for the prior year.

COST OF SALES

The Group's total cost of sales increased by RMB4,504 million or 38.3% from RMB11,772 million in the first half of 2005 to RMB16,276 million in the first half of 2006. The total cost of sales increased due to the growth in sales volume of alumina and primary aluminum, and the increased unit production costs.

SELLING AND DISTRIBUTION EXPENSES

The Group's selling and distribution expenses increased by RMB91 million or 28.5% from RMB319 million in the first half of 2005 to RMB410 million in the first half of 2006, which was primarily attributable to the increase in loading and packing fees due to the growth in sales volume of primary aluminum and alumina.

GENERAL AND ADMINISTRATIVE EXPENSES

General and administrative expenses increased by RMB400 million from RMB607 million in the first half of 2005 amounting to RMB1,007 million in the first half of 2006, representing an increase of 65.9%. The increase was mainly due to an increase of expenses of RMB94 million from the commencement of the operation of Shanxi-Huaze and newly established mining branch, Huasheng Aluminum and acquisition of Fushun Aluminum Company; an increase of RMB110 million in taxes other than income tax payable as a result of the increase in operating revenue; an increase of RMB96 million in expense relating to maintenance of roadways and infrastructure in factory and residential area; and increased expenses incurred from continued efforts to strengthen the internal control system and information system of the Group.

RESEARCH AND DEVELOPMENT EXPENSE

Research and development expenses decreased by RMB11 million or 21.2% from RMB52 million in the first half of 2005 to approximately RMB41 million in the first half of 2006.

OTHER REVENUES AND GAINS, NET

The Group's other net revenue in the first half of 2006 was RMB186 million, an increase of RMB93 million or 100% from RMB93 million in the same period of 2005. The increase of other net revenue was attributable to the fact that Chalco International Trading ("Chalco Trading"), a subsidiary of the Company, hedged some of the primary aluminum products in the futures market, resulting in an increase in other gains.

OPERATING PROFIT

As a result of the foregoing, the Group's operating profit increased by RMB4,662 million from RMB5,192 million in the first half of 2005 to RMB9,854 million in the first half of 2006, representing an increase of 89.8%. The Group's operating profit as a percentage of sales of goods was 29.1% in the first half of 2005 and 36.0% in the first half of 2006.

FINANCE COST

The Group's finance cost increased by RMB141 million or 77.9% from RMB181 million in the first half of 2005 to RMB322 million in the first half of 2006. The increase was primarily due to the commencement of production and operation upon completion of Shanxi Huaze smelting projects at the end of 2005, so that during the first half of 2006 related interest expense in the amount of RMB94 million was recognized as finance cost, rather than being capitalized as in the first half of 2005; and RMB34 million of finance costs pertaining to entities acquired or newly-established during the first half of 2006 whose results are being consolidated with the Group.

INCOME TAXES

The Group's income tax expenses increased by RMB1,229 million or 92.1% from RMB1,334 million in the first half of 2005 to RMB2,563 million in the first half of 2006. The increase of income tax was mainly attributable to the increased profit of the Company. The Group's average effective tax rate was 26.8% in the first half of 2006, essentially unchanged from 26.6% for the first half of 2005. The Group's effective tax rate was lower than the statutory tax rate of 33.0% mainly because three branches of the Company situated in Guizhou, Guangxi and Qinghai in the western region of the PRC were entitled to a preferential income tax rate of 15.0%.

MINORITY INTERESTS

Minority interests increased from RMB129 million in the first half of 2005 to RMB258 million in the first half of 2006 primarily due to the increase of the minority interests after the establishment and the acquisition of Huasheng Aluminum and Zunyi Aluminum respectively, and increased profits recorded in the Company's existing subsidiaries.

PROFIT FOR THE PERIOD

As a result of the foregoing, profit attributable to equity holders for the period increased by RMB3,190 million from RMB3,554 million in the first half of 2005 to RMB6,744 million, representing an increase of 89.8%.

DISCUSSION OF SEGMENT OPERATIONS

ALUMINA SEGMENT

Sales of Goods

The Group's total sales of goods of the alumina segment increased by RMB6,234 million, an increase of 46.50% from RMB13,407 million in the first half of 2005 to RMB19,641 million in the first half of 2006, mainly due to the increased sales volume and selling price of the Group's alumina.

Revenue from the external sales of alumina in the first half of 2006 increased by RMB3,512 million or 31.6% to RMB14,620 million as compared with RMB11,108 million for the same period of 2005. This was mainly attributable to the increase in the Group's external sales volume of alumina and increase in the selling price of alumina.

Revenue from sales of alumina to the Group's smelters increased by RMB2,722 million from RMB2,299 million in the first half of 2005 to RMB5,021 million in the first half of 2006, primarily as a result of increased selling price and total demand of alumina for use in production due to increased output of primary aluminium.

Cost of Goods Sold

The total cost of goods sold in the alumina segment of the Group increased by RMB2,602 million or 33.87% from RMB7,683 million in the same period of 2005 to RMB10,285 million in the first half of 2006. The increase was mainly attributable to the increased sales volume of alumina products over the previous year and an increased unit production cost.

Operating Profit

As a result of the foregoing, the Group's total operating profit of alumina segment increased by RMB3,413 million from RMB5,223 million in the first half of 2005 to RMB8,636 million in the first half of 2006 representing an increase of 65.35%. The ratio of operating income of the alumina segment to the Group sales of goods increased from 39.0% in the first half of 2005 to 44.0% in the first half of 2006.

PRIMARY ALUMINUM SEGMENT

Sales of Goods

The Group's total sales of goods for the primary aluminum segment increased by RMB5,869 million or 87.8% from RMB6,682 million in the first half of 2005 to RMB12,551 million in the first half of 2006, mainly due to the increases of the Group's primary aluminum sales volume and selling price.

Cost of Goods Sold

The total cost of goods sold in respect of the Group's primary aluminum segment increased by RMB4,444 million or 70.6% from RMB6,290 million in the first half of 2005 to RMB10,734 million in the first half of 2006, mainly due to the increases resulting from sales volume of primary aluminum and the unit production cost of primary aluminum.

Operating Profit

The primary aluminum segment recorded an operating profit of RMB1,566 million in the first half of 2006, increased by RMB1,396 million as compared with RMB170 million in the first half of 2005. The primary aluminum segment represented 2.54% and 12.48% of the first half year turnover of 2005 and 2006, respectively.

HEADQUARTER AND OTHER SERVICES SEGMENT

The Group's headquarter and other services segment reflected the expenses of the Group's headquarters, research and development services and product sales of the Group's research institute to external customers. This segment recorded a decrease in operating loss from RMB41.87 million in the first half of 2005 to a loss of RMB34.46 million in the first half of 2006.

WORKING CAPITAL, LIABILITIES AND CAPITAL COMMITMENTS

As of June 30, 2006, the Group's current assets amounted to RMB24,062 million, representing an increase of RMB7,099 million over RMB16,963 million at the end of 2005.

- Cash and cash equivalents of the Group as of June 30, 2006 was RMB12,132 million, representing an increase of RMB4,534 million over the end of 2005.
- The Group's inventories as of June 30, 2006 amounted to RMB8,103 million, representing an increase of RMB868 million over RMB7,235 million at the end of 2005. The Group's turnover days of inventory as of June 30, 2006 were 86 days, essentially unchanged from the corresponding period of last year.
- The Group's net accounts receivables as of June 30, 2006 amounted to RMB1,542 million, representing an increase of RMB581 million as compared with RMB961 million at the end of 2005. Of the account receivables, bills receivable and trade receivables increased by RMB437 million and RMB143 million respectively over the end of 2005. Turnover days of trade receivables were 5 days, representing a decrease of 4 days when compared to 9 days of the same period of 2005.

As of June 30, 2006, the Group's current liabilities amounted to RMB16,344 million, representing an increase of RMB1,406 million from RMB14,938 million at the end of 2005.

- In May 2005, the Group issued short-term bonds in the principal amount of RMB2,000 million at a discount and further issued short-term bonds in the principal amount of RMB3,000 million at par in May 2006 for the Company's short-term financing and working capital purposes. The entire principal amount of RMB2,000 million of short-term bond issued in 2005 were redeemed upon maturity date in June 2006.
- The other current liabilities of enterprises acquired and jointly established the first half of 2006 was approximately RMB307 million, which was consolidated in the account of the Group.

As a result of the foregoing, the Group's net current assets amounted to RMB7,718 million as of June 30, 2006, representing an increase of RMB5,693 million over the net current asset as of the end of 2005 which amounted to RMB2,025 million.

The Group's liquidity ratio as of June 30, 2006 was 1.47, representing an increase of 0.33 over the 1.14 of December 31, 2005; quick ratio was 0.98, representing an increase of 0.33 over the 0.65 as of December 31, 2005.

The Group's non-current liabilities as of June 30, 2006 amounted to RMB9,906 million, essentially unchanged from the prior year corresponding period. Of the non-current liabilities, the Group's long-term loans amounted to RMB9,729 million, similar to RMB9,690 million as of the end of 2005.

The Group's gearing ratio (total borrowing over total borrowing plus total equity) as stated in the financial report decreased to 26.18% as of June 30, 2006 from 32.05% as of December 31, 2005, a decrease of 5.87%, which was mainly because of the H shares issuance of the Company and increased profit.

CAPITAL EXPENDITURE AND CAPITAL COMMITMENTS

In the first half of 2006, the Group completed investment in fixed assets amounting to RMB4,247 million, which mainly consisted of the investment in Phase III of Guangxi alumina project, Guizhou alumina project for energy saving and consumption reduction, the self-contained power plant in Henan. As of June 30, 2006, the Group's capital commitment of fixed assets amounted to RMB9,271 million, of which those contracted but not provided for amounted to RMB1,350 million and those authorized and not contracted amounted to RMB7,921 million. The Group's external investment amounted to RMB1,541 million, mainly attributable to the joint ventures of Zunyi and Guangxi Huayin alumina projects, and the acquisition of a portion of equity in Jiaozuo Wanfang and Zunyi Aluminum. The Group's investment in and upgrade of technology as well as external investment and acquisition improved the Group's capacity and output of alumina and primary aluminum.

The Group's capital expenses and external investment is mainly financed by operating activities, long-term and short-term loans and additional shares issued. In light of the Group's creditability and various domestic and overseas financing methods, the Group believes that there will be no difficulty in financing capital investments and external acquisitions.

CASH AND CASH EQUIVALENTS

Cash and cash equivalents of the Group as of June 30, 2006 totaled RMB12,132 million, including foreign currency deposits of HK\$2,894.44 million, US\$5.26 million and Euro0.58 million.

CASH FLOWS FROM OPERATING ACTIVITIES

Cash generated from operating activities increased by RMB3,381 million or 110.5% from RMB3,061 million for the first half of 2005 to RMB6,442 million for the first half of 2006. The increase was primarily due to the increase in the Group's profit.

CASH FLOWS FROM INVESTING ACTIVITIES

Net cash used in investing activities in the first half of 2006 was RMB2,223 million, which was a decrease of RMB2,642 million from the RMB4,865 million of 2005. This was mainly due to the decrease in the cash purchase of property, plant and equipment of the Group.

CASH FLOWS FROM FINANCING ACTIVITIES

Net cash provided from financing activities amounted to RMB315 million in the first half of 2006, which was a decrease of RMB614 million compared to RMB929 million for the corresponding period of 2005. This was mainly due to the Group's placement of H shares for cash proceeds of approximately RMB4,390 million, the issuance of short-term bonds for net cash proceeds of RMB2,988 million, dividend payments of RMB2,365 million, redemption of short-term bonds in the principal amount of RMB2,000 million and repayment of loans in the amount of RMB2,694 million.

RISK OF FOREIGN EXCHANGE

The Group's revenues are primarily denominated in Renminbi ("RMB"). We use foreign currencies principally to purchase raw materials and equipment and to pay dividends on our H Shares. Because applicable foreign exchange regulations have already significantly reduced the Government's foreign exchange controls, we are able to make payments for current account transactions without prior approval from exchange control authorities. There is no assurance that such policies will continue.

However, our operations may be exposed to the effect of fluctuations in the exchange rates of RMB against other currencies. We believe that, since the price of domestic alumina is determined with reference to the price of imported alumina, the appreciation of the RMB will influence on the price fluctuation of the domestic aluminum market as well as affect prices in the domestic spot market of alumina and increase the Company's competition pressure in the international market. In respect of product cost, the appreciation of the RMB brings benefits to the import of raw materials, equipments and overseas investments.

DIRECTORS, SUPERVISORS AND SENIOR MANAGEMENT

In accordance with Articles 95 and 117 of the Company's Articles of Association, all Directors and Supervisors were appointed for a three-year term. At the expiry of the term of office, the term is renewable upon re-election. Members of the second Board of Directors and Supervisory Committee are:

Executive Directors:	Xiao Yaqing, Xiong Weiping, Luo Jianchuan, Chen Jihua
Non-executive Directors:	Shi Chungui, Joseph C. Muscari
Independent Non-executive Directors:	Poon Yiu Kin, Samuel, Wang Diansuo, Kang Yi
Supervisors:	Luo Tao, Yuan Li, Ou Xiaowu

Due to changes in work allocations, Mr. Xiong Weiping, an Executive Director, resigned from his office as a director of the Company on August 23, 2006. Mr. Zhang Chengzhong has been recommended as a candidate for the position of Executive Director of the Company previously assumed by Mr. Xiong, Mr. Zhang's appointment is subject to approval by the Special General Meeting to be held on October 13, 2006. Biographical details of Mr. Zhang are as follows:

Mr. Zhang Chengzhong, 46, is a Vice President of the Company and has been employed by the Company since 2001. Mr. Zhang obtained a Master's degree in Metallurgy Engineering. He is a professor-grade senior engineer with extensive experience in alumina production and research. Mr. Zhang previously served as the Deputy Director and then the Director of the alumina production facility in Shanxi Aluminum Plant of the Company, the Deputy Director and then the Director of the research institute affiliated with the Shanxi Aluminum Plant as well as the Deputy Director and then the Director of the Shanxi Aluminum Plant.